

GOVERNMENT OF UKRAINE  
MINISTRY OF FINANCE  
MAIN CONTROL AND REVISION OFFICE

# REPORT OF INVESTIGATIVE FINDINGS

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Pursuant to Agreement on Performance of Audit  
on the Efficiency of Use by the Respective  
Controllers of the Budget Funds in 2008-2009  
and in the First Quarter of 2010

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October 14, 2010

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TROUT CACHERIS PLLC  
AKIN GUMP STRAUSS HAUER & FELD LLP  
KROLL, INC.

*Trout Cacheris, PLLC*

## TABLE OF CONTENTS

<b>Introduction .....</b>	<b>3</b>
<b>Executive Summary .....</b>	<b>6</b>
<b>Methodology .....</b>	<b>11</b>
<b>Investigation Relating to Procurement of 27 Renault Master Vehicles by the Ministry of Emergency Situations .....</b>	<b>16</b>
<b>Investigation Relating to Procurement of Sugar by the State Material Reserve .....</b>	<b>41</b>
<b>Investigation Relating to Use of Funds Received from the Sale of Carbon Credits Pursuant to the Kyoto Protocol .....</b>	<b>56</b>
<b>Investigation Relating to Procurement of 1000 Opel Combo Leisure Activity Vehicles and Medical Equipment by the Ministry of Health .....</b>	<b>72</b>
<b>Investigation Relating to Purchase of Pharmaceutical Products and Medical Equipment by the Ministry of Health in 2008 and 2009.....</b>	<b>104</b>
<b>Investigation Relating to Land Registration Program Enacted by the Cabinet of Ministers .....</b>	<b>161</b>

## INTRODUCTION

On May 5, 2010, the Cabinet of Ministers of Ukraine issued Resolution No. 334 (the Resolution ) authorizing the audit and investigation of the use of budgetary allocations by the Government of Ukraine during the fiscal years 2008 and 2009 and the first quarter of calendar year 2010.

Pursuant to the authority granted under the Resolution, the Ministry of Finance and the Main Control and Revision Office of Ukraine (the “KRU”) engaged the law firm of Trout Cacheris, PLLC of Washington, D.C. to carry out the audit and investigation mandated by the Cabinet of Ministers. Trout Cacheris engaged the international law firm Akin Gump Strauss Hauer & Feld, LLP and the investigative and forensic audit firm Kroll, Inc. (collectively, the Investigative Firms ), along with the consulting firm First International Resources, LLC, to collaborate in the performance of the investigation and the preparation of the formal report detailing the results. On May 18, 2010, the Ministry of Finance and KRU entered into a formal agreement with Trout Cacheris (the “Agreement”), which included specific “terms of reference” that were intended to provide a guide for the selection of matters to be subjected to audit and investigation pursuant to the Resolution. While the Agreement provided for the investigative work to be completed by August 10, 2010, certain unexpected obstacles required that the date of completion be extended to September 15, 2010.

As an initial matter, 28 transactions involving the Government of Ukraine during the years 2008 and 2009 and the first calendar quarter of 2010 were identified by the KRU for further investigation. Recognizing the limited time in which the investigation was to be completed, after consultation with senior officials of the Ministry of Justice and the KRU, six specific matters were selected for in-depth audit and investigation. In making this selection, the

purpose was to identify a range of suspect activity that took place in a variety of governmental functions, rather than seeking to investigate one area of activity in great detail. In other words, the six cases that are the subject of this report were selected in an effort to provide a survey or cross-section of suspect government transactions during the stated period of time.

The investigation proceeded over a period of four months with teams of lawyers, investigators and analysts working in Kyiv, London and Washington, D.C. All investigative activity in Ukraine was conducted in close collaboration with officials of the KRU. The conduct of this case involved a full range of modern analytical tools, including forensic accounting and extensive electronic data bases, as well as traditional human intelligence work that included numerous interviews of witnesses both inside and outside Ukraine.

In the course of the investigation, several transactions were identified in which Government ministries and public enterprises suffered substantial monetary losses involving funds that were transferred outside Ukraine. Where appropriate, we have recommended that legal action be taken by the Government of Ukraine and its constituent agencies against individuals and companies responsible for these losses. To that end, as of the date of this report civil suits have been initiated in the federal courts of the United States and the High Court of Justice of England and Wales. In one instance involving a series of fraudulent schemes that targeted procurement for the State Material Reserve, the Cabinet of Ministers has authorized an expanded investigation in an effort to identify companies and banks outside Ukraine from which some of the very substantial amounts that were lost may be recovered.

In preparing this report, nearly 2,000 pages of documents have been identified and designated as exhibits to the report. These documentary exhibits, collected into five volumes and submitted with this report, were drawn from more than 250,000 pages examined in the course of

the investigation. We have worked to ensure that every material statement of fact that is made in the report is validated by one or more documentary exhibits or statements provided by witnesses with personal knowledge of the events. These exhibits constitute an integral part of this report and should be studied by anyone seeking a full understanding of this investigation.

From the beginning, there were no limitations of any kind placed on the scope, depth or details of our investigation. This investigation carried no subpoena power or other legal means to compel cooperation by individual witnesses and, in a few limited instances, individual government employees resisted or otherwise failed to cooperate in the investigation. Where such lack of cooperation or resistance occurred, the scope and nature of the uncooperative conduct has been noted in the text of the report.

Finally, and perhaps most importantly, the work of this investigation has been directed entirely toward the discovery, analysis and presentation of facts and evidence. Some of this evidence is soon to be presented in courts in Ukraine, the United States, the United Kingdom and other jurisdictions. To the extent conclusions are reached or professional opinions offered in this report, the reader is invited to study the documentary evidence to test the validity of those conclusions, professional opinions and the investigation as a whole. We are confident that our work will withstand the test.

Trout Cacheris, PLLC  
Akin Gump Strauss Hauer & Feld, LLP  
Kroll, Inc.

Kyiv, Ukraine

October 14, 2010

## **EXECUTIVE SUMMARY**

In this report, Trout Cacheris PLLC, Akin Gump Strauss Hauer & Feld LLP, and Kroll, Inc., (collectively the “Investigative Firms”) submit the results of their investigation. We have given careful consideration to the entire record, the findings, and conclusions. The report consists of this executive summary which summarizes the Investigative Firms’ basic findings and conclusions, followed by a detailed analysis of the facts and the issues as to each project. Along with this report, the Investigative Firms are submitting the accompanying documentary exhibits and other investigative materials which are relied upon in this report. The Investigative Firms are committing all of their reports and working papers to the Government of Ukraine, where they can be permanently preserved under the rules and regulations of applicable Ukrainian law.

The investigation revealed evidence of misapplication of state funds and apparent fraud involving the highest levels of the previous administration, specific ministries, and private corporations. Although the Investigative Firms lacked subpoena power, we have gathered powerful circumstantial evidence of conduct that is not typical of honest officials and businesspeople. The six topics that were examined uncovered the following findings.

1. **Investigation Relating to Procurement of 27 Renault Master Vehicles by the Ministry of Emergency Situations**

In November 2009, the Ministry of Emergency Situations entered into a contract with a Ukrainian shell company called Lakshmi Avto for the supply of 27 Renault *Master* vehicles. The contract price was UAH 799,000 per vehicle, for a total value of UAH 21,573,000. However, the vehicles had been imported into Ukraine two years earlier by routine government contractor ISS Ukraina at a price of approximately UAH 242,000 per vehicle – less than one-third of the price paid by the Ministry, despite two years of depreciation. ISS Ukraina had purchased the

vehicles from a UK company called Legal Business Consultants, which specializes in offshore incorporation. The directors of Legal Business Consultants and ISS Ukraina are connected through multiple other corporations on which they serve as directors or shareholders. In the months before the Ministry announced the tender for the vehicles, the vehicles were transferred to other closely related shell companies, for the apparent purpose of disguising the vehicles' origin and actual value. The principal of ISS Ukraina also enjoyed ties to Ministry officials who were responsible for promoting the supposed need for the vehicles and for supervising the tender process. In sum, the purchase of the vehicles was a sham transaction, using classic international money laundering mechanisms, that resulted in waste and misuse of Government funds.

**2. Investigation Relating to Procurement of Sugar by the State Material Reserve**

In February 2010, when market prices for sugar were at their peak, the State Material Reserve entered into two contracts to purchase sugar to replenish the reserves after they were sold off in August and September 2009. The contracts were brokered on the Kyiv Agro-Industrial Exchange with a Ukrainian intermediary called Hermes-Trade, for 22,150 tons of sugar at the price of UAH 11,000 per ton, for a total contract value of more than UAH 243 million. The State Material Reserve had prepaid the entire amount by March 2010, but only 5,000 tons of sugar had been delivered as of late August 2010. Sources indicated that current employees of Hermes-Trade formerly worked for the State Material Reserve. Furthermore, Hermes-Trade entered into a sham contract with a closely related UK entity, Heritage Capital Investments, for the supply of sugar from Brazil in order to fulfill the contract with the State Material Reserve. The evidence strongly suggests that the sugar transaction was structured so that private parties could benefit from state funds without even delivering sugar to the Material Reserve.

**3. Investigation Relating to Use of Funds Received from the Sale of Carbon Credits Pursuant to the Kyoto Protocol**

The Investigative Firms' investigation revealed that high-ranking government officials violated international agreements by using funds obtained through the sale of carbon credits to mask deficiencies in the Pension Fund. The National Environmental Investment Agency of Ukraine entered into five contracts during 2009 to sell carbon emission credits under the framework of the Kyoto Protocol. In exchange for the sale of carbon credits, Ukraine received 320 million, all of which was required to be maintained in segregated accounts and to be used exclusively for environmental projects. Instead, on three separate occasions, former Prime Minister Yulia Tymoshenko ordered the State Treasury to transfer the majority of the €320 million from the segregated Kyoto accounts into the general Treasury account in violation of international agreements. Most of the funds were, in turn, transferred to the Pension Fund in July and August 2009. While some of those funds were subsequently returned to the Kyoto accounts, €200 million (UAH 2.3 billion) that was transferred to the Pension Fund has not been returned. None of the €320 million received has been used on projects aimed at environmental protection, as required by the terms of the contracts. High-ranking government officials flouted these terms and misapplied the funds in order to bolster the Pension Fund.

**4. Investigation Relating to Procurement of 1000 Opel Combo Leisure Activity Vehicles and Medical Equipment by the Ministry of Health**

Following the visit of high-level Austrian officials and business leaders to Kyiv, the Ministry of Health, through state enterprise Ukrmedpostach, entered into a contract with an Austrian company called Vamed Engineering GmbH & Co. KG. Because there were no funds in the budget to procure the medical equipment and vehicles provided for by the contract, the Ministry of Health borrowed €101 million to finance the purchase. The Cabinet of Ministers authorized the debt, most of which is repayable over the course of ten years.



Under the contract, the Ministry procured 1,000 Opel Combo leisure activity vehicles, which had limited medical utility. Many of the vehicles were distributed immediately before the 2010 election with stickers that extended for the length of the cars indicating “The program of the Government of Yulia Tymoshenko.” At the time that the current Government took office, the majority of the equipment purchased from Vamed remained stored in Ukrmedpostach’s warehouse. Public resources will be diverted for the next decade to repay the debt that was incurred by the Ministry of Health and approved by the Cabinet of Ministers to purchase arguably unnecessary equipment and vehicles that appear to have been used as mobile campaign advertisements.

**5. Investigation Relating to Purchase of Pharmaceutical Products and Medical Equipment by the Ministry of Health in 2008 and 2009**

The Investigative Firms examined certain contracts between the Ministry of Health, through state enterprises, and five Ukrainian contractors in 2008 and 2009. The Ministry of Health paid the five contractors more than UAH 250 million for vaccines and medications and UAH 100 million for medical supplies. The Investigative Firms’ audit revealed that the Ukrainian entities entered into sham contracts with foreign shell companies and falsely claimed that the foreign companies had assisted in procuring vaccines, in an effort to mask the inflated prices that the Government was paying and the profits that the private companies were enjoying. The vast majority of the UAH 350 million paid to the Ukrainian contractors was subsequently transferred to the Lithuanian and Latvian bank accounts of foreign shell companies.

The Ukrainian contractors and foreign intermediaries appear to have perpetrated the fraud to circumvent Ukrainian law limiting intermediary price mark-ups to 10 percent more than the manufacturer’s price. Instead of purchasing vaccines and medical supplies from manufacturers, the Ukrainian contractors purchased the goods through intermediaries, most of which were

offshore shell companies, in order to conceal the manufacturer's price and facilitate a much more substantial mark-up. The foreign intermediaries performed no work under the contracts and added no value to the transactions but were the ultimate beneficiaries of most of the UAH 350 million in government contracts.

The Investigative Firms also note that the Ministry of Health's actions were inconsistent with its pledge to fully cooperate with the investigation. The Ministry of Health fired employees who were cooperating with the investigation and then provided inconsistent and false rationales for the firings. The Ministry of Health did not respond to document and interview requests in a timely manner and several high-ranking officials in the Ministry provided evasive or non-responsive answers to relevant questions.

**6. Investigation Relating to Land Registration Program Enacted by the Cabinet of Ministers**

In August 2009, the Cabinet of Ministers approved a Land Registration Program, which provided funding for 6.4 million citizens to register and formally own their plots of land. The program was financed by the Stabilization Fund, a special fund that was created in 2008 and designated for supporting banks and minimizing the negative effects of the recession.

Regulations that governed the use of the Stabilization Fund required the Cabinet of Ministers to obtain the approval of the Verkhovna Rada Committee on Finance and Banking and Budget Committee for expenditures from the Fund. The Investigative Firms audit confirmed that, in authorizing the land registration program, the Cabinet of Ministers failed to seek the necessary approval of the Parliamentary Committees. Former Prime Minister Tymoshenko signed a resolution in December 2009 that instructed the State Treasury to make disbursements from the Stabilization Fund without the approval of Parliament. While the rationale for using the

Stablization Fund in this manner is not known, the funds were disbursed close in time to the 2010 elections, for a popular program that could benefit citizens immediately.

### **METHODOLOGY**

The Investigative Firms commenced investigative work in May 2010 pursuant to the Agreement on performance of audit on the efficiency of use by the respective controllers of the budget funds in 2008-2009 and in the first quarter of 2010”, which was signed on behalf of the Government of Ukraine by and the Ministry of Finance and the Main Control and Revision Office (the “KRU”). The Investigative Firms conducted the investigation according to the following steps.

#### **1. Selection of Investigative Topics**

The investigative team reviewed a list of 28 potential topics for investigation, which had been compiled by the KRU based on revisions and audits that the KRU had previously conducted or that were in progress at the time. In consultation with KRU officials, five of the 28 topics were selected for further investigation in the initial phase of our work. Topic selection was based on a number of criteria, including indications of apparent misappropriation or misuse of government resources, tiered transaction structures suggesting the use of intermediaries to conceal the true nature of the transaction, and the involvement of companies and individuals outside of Ukraine.

The five topics listed below have been forensically examined during the first phase of our investigation for evidence of fraudulent activity, misappropriation, and abuse of government resources:

- The acquisition of emergency vehicles by the Ministry of Emergency Situations in 2009;
- The purchase of sugar for the State Material Reserve in February 2010.

- The use of funds received from the sale of carbon credits pursuant to the Kyoto Protocol in 2009;
- The acquisition of 1,000 Opel Combo leisure activity vehicles and medical equipment by the Ministry of Health in 2009; and
- Purchases of vaccines and medical products by the Ministry of Health between 2008 and 2010.

A sixth transaction, relating to a land registration program enacted by the Cabinet of Ministers, was later identified. The investigative team has audited and in many cases confirmed the findings of the KRU with respect to this transaction, but did not engage in the same level of comprehensive forensic investigation as was undertaken for the initial five projects.

## 2. Approach

An independent forensic investigation has been conducted in relation to each of the five topics selected with the aim of establishing, where relevant, the following:

- The terms and conditions of the transaction;
- The rationale for entering into the transaction and the method of selecting the contracting party or parties;
- The key decision makers involved in initiating the transaction;
- The use and beneficiaries of government funds;
- Whether the transaction represented fair value to the Government;
- Whether the transaction included unethical or unlawful considerations; and
- The presence of structures that may indicate fraudulent activity.

In each case, the Investigative Firms used methodology designed to ensure that the information gathered was as comprehensive as possible, in order to support a forensic

investigation into each of the projects. In this regard, the investigation relied on a combination of forensic analysis of available documentation related to each transaction, interviews with individuals in a position to comment on the transaction, and external investigative research in relation to key stakeholders in the transaction. At a high level, the Investigative Firms conducted the forensic investigation according to four main steps: documentary collection and analysis, interviews, external research, and ongoing analysis and documentation of findings.

A. *Documentary Collection and Analysis*

In the first instance, the Investigative Firms reviewed summaries prepared by the KRU in relation to each project. This was followed by initial discussions with KRU officials in order to gain a more detailed understanding of the transaction at issue, the structure of the relevant Ministries involved, and the available documentary evidence relating to the transaction. These basic discussions assisted us in formulating a conceptual structure of the transaction, including the ability to identify documents and other information that we would expect to be available.

The Investigative Firms then submitted detailed document requests to the relevant ministries and governmental departments. Throughout our investigation, this process was ongoing, and numerous follow-up requests were submitted as our knowledge of a transaction increased. The nature of information requested included, but was not limited, to contracts, invoices, internal and external correspondence, bank transfers and other account records, customs documentation, tender documentation, and government decrees. The documentary collection and analysis did not extend to email correspondence or forensic imaging of the computer files maintained by key suspects or government officials. Lacking subpoena power, the Investigative Firms were unable to access and review certain bank account records, correspondence, and other documents in the possession of non-governmental parties.

The documents that we received were forensically analyzed in an effort to compile a complete paper trail from the transaction's initiation to its conclusion. The document review process also permitted us to identify individuals who played a key role in the transaction and with whom interviews could be conducted.

#### B. *Interviews*

After conducting an initial review of available documentary evidence relating to a transaction, the Investigative Firms requested interviews with individuals within the Government who were identified as having been connected to the decision making and authorization process. These interviews were informal and were not taken under oath, nor were they transcribed, taped or recorded by any method. The purpose of these informal interviews was to gain further context as to our findings from the document analysis aspect of the investigation, as well as to obtain additional information relating to the rationale for the transaction and the primary decision-makers. We conducted more than fifty interviews of officials of various government ministries and state-owned enterprises. It was generally outside the scope of the Investigative Firms' mandate to contact third parties and corporations that contracted with the Government for interviews. To facilitate the disclosure of information, as well as to protect the professional and personal reputation and safety of those involved in the process, the identity of those interviewed is not disclosed in this report.

#### C. *External Research*

The Investigative Firms conducted a substantial amount of external, international investigative research in relation to each of the projects. We consulted public records and other sources to obtain additional information relating to corporate ownership, pricing of products, and to discern connections between contractors and government officials. The purpose of this aspect

of our work was to expand upon our findings from the document review and interview processes, and to understand further the role of third parties in transactions and their potential connections to key government decision makers.

D. *Synthesis of Findings*

The information that we identified in relation to each project was continuously analyzed, reviewed, and documented in order to take into account findings as they developed. Interim reports were prepared and at the conclusion of the investigation our findings were compiled into more formal reports, which referenced appropriate source documentation for each assertion made. This final report represents the culmination of our efforts.

# **INVESTIGATION RELATING TO** **PROCUREMENT OF 27 RENAULT VEHICLES** **BY THE MINISTRY OF EMERGENCY** **SITUATIONS**

## **Table of Contents**

<b>I.</b>	<b>Introduction .....</b>	<b>17</b>
<b>II.</b>	<b>Executive Summary .....</b>	<b>17</b>
<b>III.</b>	<b>Investigative Findings.....</b>	<b>21</b>
<b>A.</b>	<b>Two Former Officials of the Ministry of Emergency Situations Played Significant Roles in the Purchase of the Emergency Medical Vehicles .....</b>	<b>21</b>
1.	<i>Request and Budgeting for Emergency Medical Vehicles.....</i>	<i>22</i>
2.	<i>Tender Process .....</i>	<i>23</i>
3.	<i>Evaluation of Bids.....</i>	<i>23</i>
4.	<i>Contract between Ministry and Lakshmi Avto .....</i>	<i>25</i>
<b>B.</b>	<b>The Vehicles Were Transferred Between Related Individuals and Shell Companies .....</b>	<b>26</b>
1.	<i>Legal Business Consultants: Specializes in Offshore Incorporation.....</i>	<i>27</i>
2.	<i>ISS Ukraina: Repeat Government Contractor .....</i>	<i>29</i>
3.	<i>Eurospetstrans: Shell Company Created to Mask ISS Ukraina's Role .....</i>	<i>32</i>
4.	<i>Lakshmi Avto: Shell Company Created to Mask ISS Ukraina's Role .....</i>	<i>33</i>
5.	<i>Companies Involved in Supply of Vehicles Had Inside Connections to the Ministry of Emergency Situations and Created Shell Entities to Conceal Those Relationships.....</i>	<i>34</i>
6.	<i>Summary Timeline.....</i>	<i>37</i>
<b>C.</b>	<b>The Ministry Paid a Grossly Inflated Price for the Vehicles.....</b>	<b>38</b>
<b>D.</b>	<b>The Vehicles Remain Substantially Unused .....</b>	<b>39</b>
<b>IV.</b>	<b>Conclusions and Recommendations.....</b>	<b>39</b>



## **I. Introduction**

This report details the manipulation of a tender process by individuals connected to former officials of the Ministry of Emergency Situations in order to sell vehicles to the Government at a substantially inflated price and thereby profit at the people's expense.

The investigation conducted with respect to this report is governed by the following sections of the Terms of Reference:

- Performance of the state budget in respect of revenues and expenditures. Terms of Reference I.1.
- Public procurement of goods, works and services and compliance with generally prescribed competitive procedures. Terms of Reference I.4.
- Evaluation with respect to compliance with the legislation of Ukraine, international law and practice in all areas set out in these Terms of Reference. Terms of Reference II.
- Conclusion on impact of discovered violations on the state economy. Terms of Reference II.
- Proposals regarding specific measures for improvement of the financial and economic situation in the state. Terms of Reference II.

## **II. Executive Summary**

On October 15, 2009, the official government procurement website published a tender for the acquisition of 27 medical vehicles by the Ministry of Emergency Situations. Four companies participated in the tender: Ukrainian entities Lakshmi Avto, ISS Ukraina and Intekhservice, and Spanish entity Emergencia 2000. The bids were evaluated on

November 11, 2009, and Lakshmi Avto was announced the winner of the tender the next day.

On November 20, 2009, the Ministry of Emergency Situations and Lakshmi Avto entered into a contract for the supply of 27 Renault *Master* vehicles, at the price of UAH 799,000 per vehicle for a total of UAH 21,573,000. Details relating to the tender process, the origin of the vehicles, and the profiles of the individuals and corporations involved in the chain of supply reveal that the purchase of the 27 emergency medical vehicles was a sham transaction designed solely for profit by third parties.

Although the Ministry paid UAH 799,000 for each vehicle, the vehicles had been purchased two years earlier for approximately UAH 242,000 each. In November 2007, ISS Ukraina – which ultimately participated in the tender – entered into a contract to purchase Renault *Master* vehicles, supplied by Emergencia 2000 – another tender participant – from a London-based company that specializes in offshore incorporation called Legal Business Consultants. ISS Ukraina imported the vehicles into Ukraine between January 2008 and February 2009.

On April 24, 2009, the 50 percent shareholder of ISS Ukraina, Lilya Granitir, established another Ukrainian entity called Eurospetstrans. Lilya transferred her interest in ISS Ukraina to the other 50 percent shareholder – Zhelko Granitir, with whom she shares a surname and an address – on May 28, 2009. At some point after its incorporation, Eurospetstrans came to possess the vehicles.

Lakshmi Avto was incorporated on September 15, 2009. This incorporation date was three days before the ministerial request to purchase the vehicles was made. On

October 9, 2009, Eurospetstrans entered into a dealership contract with Lakshmi Avto, which gave Lakshmi Avto the right to sell 27 Renault *Master* vehicles owned by Eurospetstrans at a minimum price of UAH 471,000 per vehicle. On that same date, the tender committee within the Ministry of Emergency Situations approved the publication of the tender documentation. On the same day that the tender was publicized, Lakshmi Avto entered into a contract with a Slovakian entity called PANAX F.C.S. spol. s.r.o., providing that PANAX would convert Renault *Master* cars so that they were suitable for use as emergency medical vehicles.

The contract between Lakshmi Avto and the Ministry described the vehicles as manufactured by PANAX, but all the evidence shows that PANAX was not the manufacturer and in fact only performed limited service on the vehicles. Rather, both customs documentation and the contract between Legal Business Consultants and ISS Ukraina stated that Emergencia 2000 was the manufacturer. Because Emergencia 2000 was one of the bidders in the tender process, a fair inference is that PANAX was listed as manufacturer to disguise the true origin of the vehicles and the inflation of their actual value.

The bid that Lakshmi Avto – a first-time tender participant – submitted to the tender committee was almost identical to the confidential amount that had been budgeted for the purchase of the vehicles. In contrast, experienced bidder ISS Ukraina overbid by nearly UAH 7 million, and Emergencia 2000 overbid by UAH 4 million. It is apparent that Lakshmi Avto is a shell company and may be controlled by the principals of ISS Ukraina and Eurospetstrans. Among other indicators, Lakshmi Avto does not exist at the

address listed on the contract with the Ministry; in fact, a police station is located at that address. There is no publicly available information relating to Lakshmi Avto's supposed sole director and shareholder, Sergei Nikogda, raising suspicions that he is a fictional character.

Despite two years of depreciation, the Ministry of Emergency Situations paid Lakshmi Avto UAH 15 million more for the 27 vehicles than the price that ISS Ukraina had paid. The investigation has indicated possible beneficiaries of that inflated sum, including former Ministry officials and principals of the corporations involved in the chain of supply. Namely, Zhelko Granatir is a Croatian national who has utilized his contacts in Ukraine to assist Croatian businesses in gaining introductions to the Ukrainian government. In 2009 and 2010, Granatir coordinated events to promote Croatian entity DOK-ING's business in Ukraine. The events were attended by former Deputy Minister of Emergency Situations V.M. Baranchuk, who was instrumental in promoting the supposed need for the vehicles and participating in the tender process. Granatir is also closely linked to the principals of Legal Business Consultants, Igor Krota and Sandro Stipancic, who are also Croatian. Granatir's corporate interests in the UK are closely connected with Krota's and Stipancic's through common directors and shareholders, suggesting a historical business relationship between the two individuals prior to the sale of the emergency vehicles.

In sum, the Ministry misapplied state funds to purchase these vehicles – many of which are not being used – at an inflated price. The evidence reviewed and interviews conducted strongly suggest that the purchase of the vehicles was a sham transaction, in

which Lakshmi Avto seemed assured to win the contract, intended to transfer government funds to private hands. The individuals who profited from the scheme used international money laundering mechanisms such as creating networks of offshore shell companies in order to conceal the true nature of the transaction and the identity of the beneficiaries.

### **III. Investigative Findings**

#### **A. Two Former Officials of the Ministry of Emergency Situations Played Significant Roles in the Purchase of the Emergency Medical Vehicles**

Deputy Minister V.M. Baranchuk and I.U. Babunich, director of the Department for Material and Technical Procurement within the Ministry and deputy head of the tender committee, played key roles in formulating the need for the vehicles and in carrying out the tender process. As discussed below in greater detail, these former officials have connections to Zhelko Granatir, whose company imported the vehicles, facilitated their transfer, and bid on the contract in an apparent attempt to manipulate the tender process.

Babunich was fired by the Minister of Emergency Situations in March 2010 after investigations by the KRU, the Ministry of Internal Affairs, and the State Security Service. The Investigative Firms were informed that those investigations revealed systematic misconduct.<sup>1</sup> Baranchuk's resignation was accepted by the Cabinet of Ministers formed by the new Government.<sup>2</sup>

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<sup>1</sup> Interview of confidential source, July 15, 2010

<sup>2</sup> *Id.*

1. *Request and Budgeting for Emergency Medical Vehicles*

In 2008, the Ministry of Emergency Situations began drafting a development plan to document the Ministry's needs in the years ahead. On February 25, 2009—after ISS Ukraina had imported all of the vehicles purchased from Legal Business Consultants—the Cabinet of Ministers ratified that development plan, which was entitled “State Social Program for the Development of Civil Defense from 2009 to 2013.”<sup>3</sup> Among other things, the document stated that 44 emergency medical vehicles should be purchased. Internally, Ministry officials estimated that the cost per vehicle would be approximately UAH 800,000 per vehicle. Sources could not recall exactly how the price was calculated but suspected that the figure was based on internet research and price lists of companies that contract with the Ministry of Health.<sup>4</sup> Although the UAH 800,000 figure was never made public, Lakshmi Avto's bid was, remarkably, UAH 799,000 per vehicle.

The Ministry began implementing the development plan in April 2009.<sup>5</sup> In accordance with the plan, a Ministry employee wrote to Deputy Minister Baranchuk on September 1 and 18, 2009 to request the purchase of the emergency vehicles.<sup>6</sup> The letters or “reporting notes” requested 18 vehicles, the minimum that the employee believed were required.<sup>7</sup> Baranchuk and Babunich (head of the tender committee) would have been involved in the decision to acquire the vehicles through the tender process at that time.<sup>8</sup> A source reported that UAH 21,805,176 in surplus funds became available in the

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<sup>3</sup> Exhibit 1: UA0002904.

<sup>4</sup> Interviews of confidential sources, June 29 and 30, 2010.

<sup>5</sup> Exhibit 2: UA0002893.

<sup>6</sup> Exhibit 3: UA0002890; Exhibit 4: UA0002889.

<sup>7</sup> Interview of confidential source, June 30, 2010.

<sup>8</sup> Interviews of confidential sources, June 29 and 30, 2010.

Ministry's budget, also in September 2009, to allow for purchase of the vehicles.<sup>9</sup> Again, although this sum was never published, Lakshmi Avto's bid was in almost the exact amount budgeted by the Ministry.

## *2. Tender Process*

At an October 2, 2009 meeting of the Tender Committee of the Ministry of Emergency Situations, a Ministry employee made the formal request to the Committee for 44 emergency vehicles and reported that UAH 21,805,176 was available to purchase the vehicles. The Tender Committee met again on October 9, 2009. At this meeting, the Committee voted in favor of the procurement of 27 vehicles, approved the tender documentation, and decided to publish the tender and solicit bids beginning on October 12. According to a source, 27 vehicles were ultimately requested, instead of 44 or 18, because the Ministry divided the amount in the budget (UAH 21,805,176) by the estimated cost per vehicle (UAH 800,000) and concluded that 27 could be purchased. Baranchuk and Babunich attended both meetings of the Tender Committee.<sup>10</sup>

The tender documentation was published on the official government procurement website on October 15, 2009. The deadline for submitting bids was November 11 at 10:00 a.m., and vehicles were to be supplied in November and December 2009.

## *3. Evaluation of Bids*

The Tender Committee received a total of four bids. The bidders were Emergencia 2000, ISS Ukraina,<sup>11</sup> Lakshmi Avto,<sup>12</sup> and Intekhservice.<sup>13</sup> The bids were

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<sup>9</sup> Interview of confidential source, June 29, 2010.

<sup>10</sup> Interview of confidential source, June 29, 2010.

<sup>11</sup> Exhibit 5: UA0001781.

<sup>12</sup> Exhibit 6: UA0001512.

opened on November 11, and representatives of Emergencia 2000 and ISS Ukraina were present for the opening. The evaluation of the bids took place on the same day, and Baranchuk, Babunich, and four other Tender Committee members signed the paperwork relating to the bid evaluation. Sources indicated that they did not believe that any corporate due diligence was conducted on the bidders themselves, nor did these sources undertake any such research.<sup>14</sup>

The basic details relating to the four companies' bids are summarized in the table below:

Company	Total offer price	Price per unit	Vehicles offered
ISS Ukraina	UAH 28,215,000	UAH 1,045,000	Volkswagen Crafter
Emergencia 2000	UAH 26,703,000	UAH 989,000	Renault Master L2H2
Lakshmi Avto	UAH 21,573,000	UAH 799 000	Renault Master L2H2
Intekhservice	UAH 17,000,000	Not indicated	Not indicated

Although Intekhservice was the low bidder, the Tender Committee concluded that Intekhservice had provided adequate information for only three of 21 criteria stipulated in the tender and therefore rejected that bid. Emergencia 2000's bid was deemed to fall short of certain technical requirements and was also rejected. Primarily because Lakshmi Avto's bid was almost UAH 7 million lower than ISS Ukraina's, Lakshmi was selected the winning bidder on November 12.<sup>15</sup> As noted above, Lakshmi Avto's bid was in

<sup>13</sup> Exhibit 7: UA0001763.

<sup>14</sup> Interviews of confidential sources, June 29 and 30, 2010.

<sup>15</sup> Exhibit 8: UA0000568.



almost the exact confidential amount that the Ministry had budgeted for the total contract and the per vehicle price. In contrast, the bid of ISS Ukraina seems off target for an experienced government contractor. This and other evidence suggests that the individuals behind Lakshmi Avto and ISS Ukraina had access to internal Ministry information and colluded in submitting their bids to ensure that Lakshmi Avto would be selected.

#### 4. *Contract between Ministry and Lakshmi Avto*

On November 20, 2009, the Ministry of Emergency Situations and Lakshmi Avto signed a contract for the supply of 27 emergency medical vehicles.<sup>16</sup> The total contract value was UAH 21,573,000, or UAH 799,000 per vehicle. The contract was signed by Deputy Minister Baranchuk on behalf of the Ministry, and by Sergei Nikogda on behalf of Lakshmi Avto. The vehicles were described in the contract as Renault *Master* L2 H2s, manufactured by PANAX F.C.S, s.r.o ( PANAX ). However, import documentation relating to the vehicles lists the manufacturer as Emergencia 2000. PANAX and Lakshmi Avto had entered into a contract on October 15, 2009, whereby PANAX was to convert the vehicles to be suitable for use as emergency medical vehicles.<sup>17</sup> The total cost of conversion was €20,000, adding approximately 740 of value per vehicle. As Emergencia 2000 was one of the bidders in the tender process, one reasonable inference is that PANAX was listed as the manufacturer, despite its relatively insignificant task of converting the vehicles, in an attempt to disguise the origin of the vehicles.

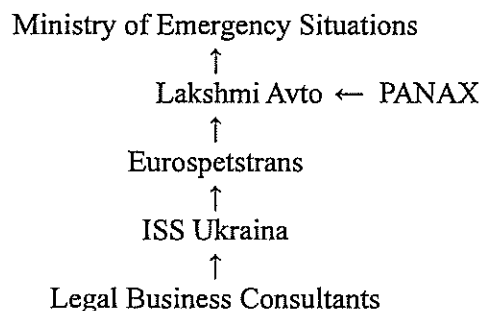
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<sup>16</sup> Exhibit 9: UA0000339-UA0000344.

<sup>17</sup> Exhibit 10: UA0000452.

**B. The Vehicles Were Transferred Between Related Individuals and Shell Companies**

The vehicles that Lakshmi Avto sold to the Ministry of Emergency Situations first entered Ukraine in 2008 and early 2009 pursuant to a 2007 contract between a Ukrainian entity called ISS Ukraina and a UK corporation named Legal Business Consultants Ltd. In April 2009, one of the two shareholders of ISS Ukraina formed a new Ukrainian entity called Eurospetstrans. At some point during the ensuing months, the vehicles came into the possession of Eurospetstrans. Eurospetstrans then entered into a dealership agreement with Lakshmi Avto that permitted Lakshmi to sell the vehicles subject to a minimum price. In sum, the vehicles were transferred according to the following chain of supply:



Our investigation has revealed relationships between Legal Business Consultants, ISS Ukraina, Eurospetstrans, and former Ministry officials.

1. *Legal Business Consultants: Specializes in Offshore Incorporation*

a. Corporate profile

Legal Business Consultants Ltd. is a UK company<sup>18</sup> that specializes in offshore incorporation and banking advice, tax planning structures, and car and yacht registration in low-tax jurisdictions. There is no evidence that Legal Business Consultants sells cars or any other goods.<sup>19</sup> A related company, Legal Business Consultants d.o.o., is registered in Croatia<sup>20</sup> and owned by Legal Business Consultants Limited, a Belize company.<sup>21</sup> The company has two directors, Igor Kkota and Sandro Stipancic, and each owns 50 percent of the company.<sup>22</sup> Both are Croatian nationals and are listed as directors and/or shareholders of multiple corporations in the UK, Croatia, and Czech Republic. Most importantly, Kkota and Stipancic are joint owners of two UK entities called Tylney Directors Limited and Tylney Secretaries Limited, which are connected to the principal of ISS Ukraina and his corporate affiliations, as described below in additional detail. Kkota is a director of three additional entities—Nominee Co. Secretaries Limited, Corp Directors Limited,<sup>23</sup> and Corp Secretaries Limited—that are linked to corporations in which the principal of ISS Ukraina has an interest.

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<sup>18</sup> Exhibit 11: UA0005470.

<sup>19</sup> Exhibit 12: UA0005919; Exhibit 13: UA0005917; Exhibit 14: UA0005924.

<sup>20</sup> Exhibit 15: UA0005379.

<sup>21</sup> Exhibit 16: UA0005378.

<sup>22</sup> Exhibit 17: UA0005462.

<sup>23</sup> Exhibit 18: UA0005334.

b. Transfer from Legal Business Consultants to ISS Ukraina

Legal Business Consultants and ISS Ukraina entered into a contract on November 1, 2007 for the supply of 6 medical vehicles at a total cost of €200,000.<sup>24</sup> On January 10, 2008, the contract was amended to provide that ISS Ukraina would purchase 60 vehicles for a total price of €2 million.<sup>25</sup> The contract indicated that the vehicles were manufactured by Emergencia 2000, a Spanish entity. Because the vehicles were specified as Renaults in invoices and customs documentation, it is unlikely that Emergencia 2000 actually “manufactured” them, but Emergencia 2000 does appear to be genuinely involved in the supply of medical vehicles. There is no evidence to date to suggest how Legal Business Consultants obtained the vehicles. Sandro Stipancic signed the contract on behalf of Legal Business Consultants, and Zhelko Granatir signed for ISS Ukraina.

Customs documentation shows that the vehicles were imported by ISS Ukraina between January 2008 and February 2009, although the vast majority of cars were delivered between January and March 2008. The invoices to ISS Ukraina contain an identification number for the cars sold.<sup>26</sup> A comparison of the invoices with the identification numbers of the vehicles sold to the Ministry show that at least 26 out of 27 are the same cars that were imported by ISS Ukraina.

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<sup>24</sup> Exhibit 19: UA0000408.

<sup>25</sup> Exhibit 20: UA0000420-UA0000422.

<sup>26</sup> Exhibit 21: UA0000423.

2. *ISS Ukraina: Repeat Government Contractor*

a. Corporate profile

ISS Ukraina was incorporated in Ukraine on February 4, 2000 and has a substantial public profile as a supplier of goods to the Government, including the Ministry of Health, the military, the State Security Service, and the Ministry of Emergency Situations. For example, in December 2000, ISS Ukraina won a tender to supply medical equipment to the Naval Forces of Ukraine. In May 2005, the company supplied medical equipment to a regional health care facility run by the Ministry of Health. The company supplied medical vehicles to the State Security Service of Ukraine in September 2009. A source also stated that ISS Ukraina previously supplied helicopters to the Ministry of Emergency Situations.<sup>27</sup>

Zhelko Granatir is currently the sole shareholder and director of ISS Ukraina.<sup>28</sup> As discussed below, he became the 100 percent owner of ISS Ukraina when Lilya Granatir, who shares a surname and address with Zhelko, transferred her 50 percent interest in the company to Zhelko.<sup>29</sup>

b. Connections to Legal Business Consultants

Zhelko Granatir and Legal Business Consultants principals Igor Krota, and Sandro Stipancic are all Croatian nationals and are linked by corporations of which they serve or have served as directors. Namely, Granatir is currently director of two companies incorporated in the UK called Invest Consulting Company Ltd. ("Invest

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<sup>27</sup> Interview of confidential source, July 15, 2010.

<sup>28</sup> Exhibit 22: UA0003414; Exhibit 23: UA0002958.

<sup>29</sup> Confidential sources.

Co.”)<sup>30</sup> and Invest Consulting Center Ltd. (“Invest Center”).<sup>31</sup> Companies that are or have been officers, directors, or shareholders of Invest Co. and Invest Center are connected to Kkota, Stipancic, and Legal Business Consultants.

i. Invest Co.

Invest Co. was incorporated in the UK in February 2008<sup>32</sup> and has been dormant since that time. Before Granatir was appointed as sole director in February 2009, Tylney Directors Limited was the sole director.<sup>33</sup> Tylney Directors has been dormant since its incorporation in 2000.<sup>34</sup> Currently, Kkota and Stipancic are directors and shareholders of Tylney Directors,<sup>35</sup> and Stipancic also formerly acted as secretary.<sup>36</sup>

Tylney Secretaries Limited and Corp Secretaries Limited have served as secretaries of Invest Co. Granatir became sole shareholder of Invest Co. in February 2009. Before that time, Tylney Directors and Tylney Secretaries each held a 50 percent interest. Corp Secretaries was incorporated in March 2010 and is registered at the same address as Legal Business Consultants and several other entities associated with or beneficially owned by Kkota and Stipancic.<sup>37</sup> Kkota is the sole director of Corp Secretaries, and an entity called Nominee Co Secretaries Limited is its secretary.<sup>38</sup> Kkota is also director of Nominee Co Secretaries Limited.<sup>39</sup> Tylney Secretaries Limited is

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<sup>30</sup> Exhibit 24: UA0005439.

<sup>31</sup> Exhibit 25: UA0005427.

<sup>32</sup> Exhibit 26: UA0005444; Exhibit 27: UA0005435.

<sup>33</sup> Exhibit 28: UA0005442.

<sup>34</sup> Exhibit 29: UA0005501.

<sup>35</sup> Exhibit 30: UA0005493.

<sup>36</sup> Exhibit 31: UA0005498.

<sup>37</sup> Exhibit 32: UA0005357; Exhibit 33: UA0005358.

<sup>38</sup> Exhibit 34: UA0005356.

<sup>39</sup> Exhibit 35: UA0005483.

wholly owned by Krota and Stipancic,<sup>40</sup> was incorporated in 1998, and has been dormant since then.<sup>41</sup> Tylney Secretaries also served as secretary of Legal Business Consultants from February 2007 to April 2010,<sup>42</sup> and the two companies shared the same address at one time. Krota is the sole director of Tylney Secretaries, and Tylney Directors is its secretary.<sup>43</sup> At previous times, Krota and Stipancic each acted as secretary.

ii. Invest Center

Invest Center was incorporated in July 1999<sup>44</sup> and was registered at the same addresses as Legal Business Consultants, at the same time.<sup>45</sup> The current owners of Invest Center are Tylney Directors and Tylney Secretaries, but past ownership was transferred between these two entities, Granatir, Legal Directors Limited, Legal Secretaries Limited, and two entities incorporated in the Isle of Man.<sup>46</sup> As discussed above, Krota and Stipancic own Tylney Directors and Tylney Secretaries.

Tylney Directors was formerly a director of Invest Center, and Tylney Secretaries currently serves as the company secretary. Other former directors and officers of Invest Center include Legal Secretaries Limited and Legal Directors Limited. Legal Secretaries Limited served as secretary of Tylney Directors from April 2000 to October 2004, secretary of Invest Center from November 1999 to June 2006, and secretary of Legal Business Consultants from March 2000 to February 2007.

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<sup>40</sup> Exhibit 36: UA0005567.

<sup>41</sup> Exhibit 37: UA0005573.

<sup>42</sup> Exhibit 38: UA0005467.

<sup>43</sup> Exhibit 39: UA0005571.

<sup>44</sup> Exhibit 40: UA0005434.

<sup>45</sup> See, e.g., Exhibit 41: UA0005395; Exhibit 42: UA0005424.

<sup>46</sup> See, e.g., Exhibit 43: UA0005385; Exhibit 44: UA0005412; Exhibit 45: UA0005415; Exhibit 46: UA0005419; UA0005427 (cited above as Exhibit 25).

In sum, Granatir serves as director of one company that is owned by two corporations that are in turn owned by Krota and Stipancic, and of another entity that counts corporations beneficially owned by Krota and Stipancic as former directors, officers, and shareholders.

3. *Eurospetstrans: Shell Company Created to Mask ISS Ukraina's Role*

a. Incorporation and connections to ISS Ukraina

At some point between April and October 2009, Eurospetstrans came to possess the vehicles. Although we could not obtain a copy of the private contract between Eurospetstrans and ISS Ukraina, it is apparent that the two companies are closely related. Eurospetstrans was incorporated in Ukraine on April 24, 2009.<sup>47</sup> The founder and sole shareholder of Eurospetstrans is Lilya Granatir, who shares a surname and address with Zhelko Granatir, the shareholder of ISS Ukraina. Lilya Granatir was formerly a shareholder of ISS Ukraina but transferred her 50 percent interest to Zhelko, who became the sole owner, on May 28, 2009. Neither Eurospetstrans or its director, Ivan Radyk, has a significant public profile.

b. Dealership agreement with Lakshmi Avto

On October 9, 2009, Eurospetstrans and Lakshmi Avto entered into a dealership agreement that granted Lakshmi Avto the right to sell 27 Renault Master vehicles owned by Eurospetstrans.<sup>48</sup> The contract provided that the vehicles should be sold at a minimum of UAH 471,000 per car, and Lakshmi Avto would receive a commission of UAH 10,000

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<sup>47</sup> UA0002958 (cited above as Exhibit 23). Confidential sources.

<sup>48</sup> Exhibit 47: UA0000449.



per car sold. The dealership agreement was signed on the same day that the Tender Committee approved and voted to publish the tender documentation relating to the vehicles. Despite the dealership agreement between Eurospetstrans and Lakshmi Avto, PANAX provided a letter to the Tender Committee indicating that Lakshmi Avto was authorized by PANAX as a dealer and distributor of the vehicles.<sup>49</sup>

4. *Lakshmi Avto: Shell Company Created to Mask ISS Ukraina's Role*

Lakshmi Avto was incorporated in Ukraine on September 15, 2009—at the same time that Deputy Minister Baranchuk was shepherding the requests for the vehicles through the Ministry and the Tender Committee, and barely two months before Lakshmi Avto was awarded the contract.

Ukrainian corporate filings and the contract between Lakshmi Avto and the Ministry state that Lakshmi Avto's address is 25a Ulica Avtozavodskast, Kyiv. However, a site visit revealed that no company by the name of Lakshmi Avto was located at that address. Instead, a police station is located there.<sup>50</sup> KRU's visit to Lakshmi Avto three months prior to the Investigative Firms' site visit also indicated that the company was not present at that address.<sup>51</sup> There is no information available regarding Sergei Nikogda, the alleged sole director and shareholder. The evidence raises suspicions that Lakshmi Avto is a shell company created by the principals of ISS Ukraina and Eurospetstrans. In this way, those individuals could manipulate the tender process to ensure that Lakshmi Avto

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<sup>49</sup> Exhibit 48: UA0000355.

<sup>50</sup> Site visit, July 1, 2010.

<sup>51</sup> Exhibit 49: UA0000459.

won this contract and could conceal the chain of supply and the markups to the price of the vehicles.

5. *Companies Involved in Supply of Vehicles Had Inside Connections to the Ministry of Emergency Situations and Created Shell Entities to Conceal Those Relationships*

The investigation also revealed connections between Zhelko Granatir and Deputy Minister Baranchuk, linking the corporations and individuals involved in the chain of supply to a high-level official of the Ministry of Emergency Situations. Granatir's media profile in Croatia relates to his dealings with a Croatian entity called DOK-ING, a producer of de-mining vehicles and equipment. In 2009 and 2010, Granatir coordinated events in Ukraine at which DOK-ING marketed its products. The events were high-profile and were attended by government officials, including Deputy Minister Baranchuk.

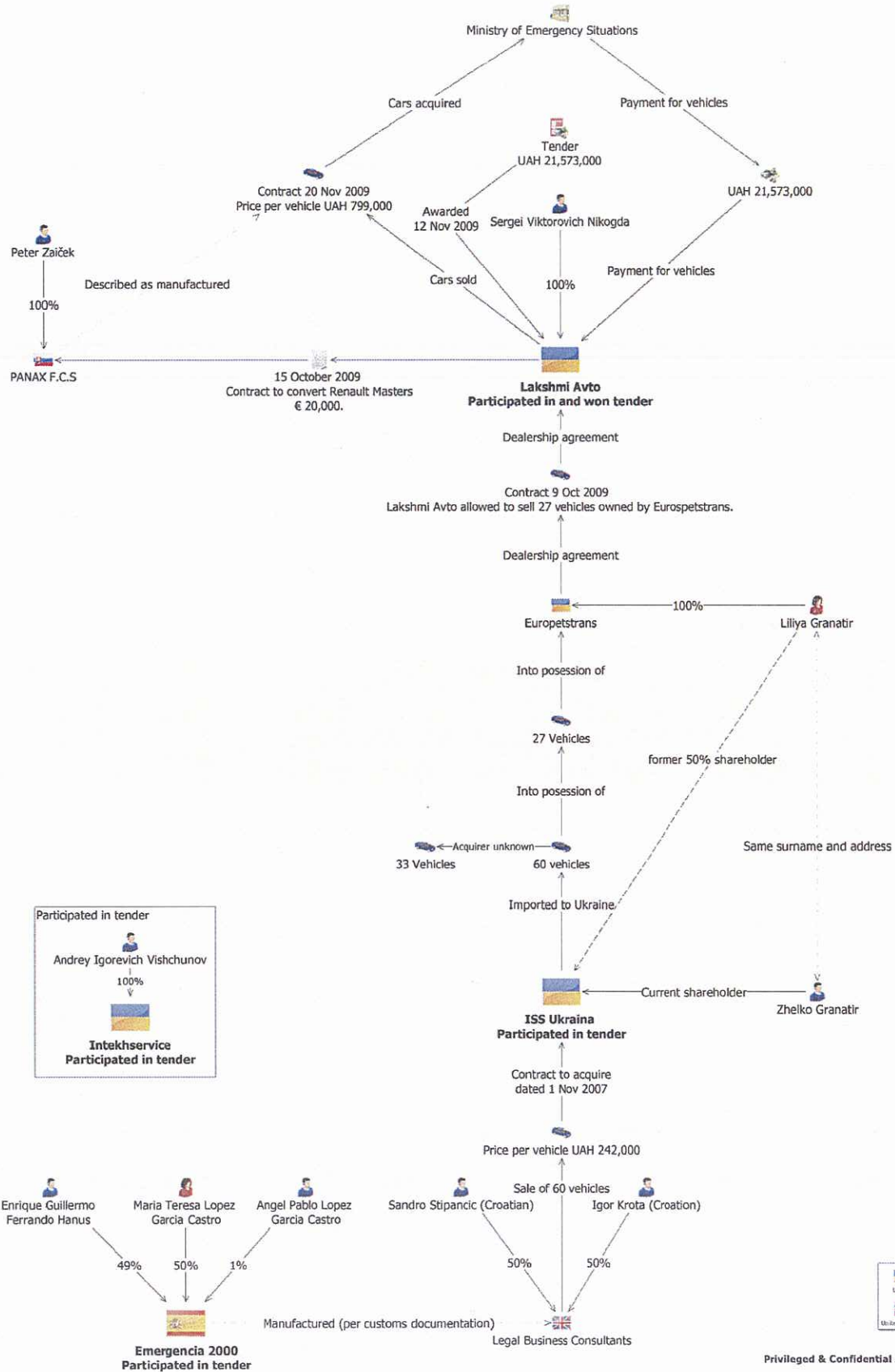
Also in 2009, representatives of the Ministry of Emergency Situations of Ukraine traveled to Croatia and signed a protocol relating to cooperation in de-mining and other peacekeeping activities. The protocol was signed by Baranchuk on behalf of the Ministry. DOK-ING attended the meetings as a representative of the Croatian government. The Ukrainian representatives were interested in DOK-ING's de-mining vehicles, so DOK-ING arranged a visit to Ukraine. The Croatian Embassy in Kyiv initially assisted DOK-ING, but suggested that DOK-ING instead find an individual in Kyiv to facilitate the visit and meetings. Granatir was selected to undertake that work.<sup>52</sup>

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<sup>52</sup> Confidential sources.

The chart on the following page illustrates the chain of supply and the relationships among the various individuals and corporations that were involved in transferring the vehicles.

# Supply of Vehicles



Privileged & Confidential At Direction of Counsel

## 6. *Summary Timeline*

The timeline below summarizes the events leading to the procurement of the 27 emergency medical vehicles and illustrates the significance of key dates.

- November 1, 2007: Legal Business Consultants and ISS Ukraina enter into 200,000 contract for the supply of 6 medical vehicles
- January 10, 2008: Legal Business Consultants and ISS Ukraina amend contract to provide for supply of 60 vehicles, at €33,333 per vehicle.
- April 24, 2009: Eurospetstrans is incorporated.
- May 28, 2009: Lilya Granatir, sole shareholder of Eurospetstrans, transfers her 50 percent interest in ISS Ukraina to Zhelko Granatir who becomes sole shareholder of ISS Ukraina.
- September 15, 2009: Lakshmi Avto is incorporated.
- October 2, 2009: Tender Committee meets and discusses the need for 44 medical vehicles.
- October 9, 2009: Tender Committee meets again to approve publication of tender for 27 medical vehicles. Eurospetstrans and Lakshmi Avto enter into dealership contract granting Lakshmi the right to sell 27 Renault Master medical vehicles.
- October 15, 2009: Tender is published on the government website. Lakshmi Avto contracts with PANAX to convert the cars to be suitable for use as emergency vehicles.
- November 11, 2009: Four bids are opened and evaluated.
- November 12, 2009: Lakshmi Avto is selected the winning bidder.
- November 20, 2009: Lakshmi Avto (S.V. Nikogda) and Ministry of Emergency Situations (Deputy Minister V.M. Baranchuk) sign contract for supply of 27 vehicles for a total price of UAH 21,573,000.
- December 2009: Lakshmi Avto delivers vehicles and is paid by Ministry of Emergency Situations.

### C. The Ministry Paid a Grossly Inflated Price for the Vehicles

The Renault *Master* vehicles were initially imported into Ukraine by ISS Ukraina between January 2008 and February 2009. Customs documentation<sup>53</sup> and the contracts between ISS Ukraina and Legal Business Consultants, dated November 1, 2007<sup>54</sup> and January 10, 2008,<sup>55</sup> show that the Ministry of Emergency Situations paid nearly triple the price for the same vehicles, despite their depreciation.

In 2007, ISS Ukraina paid €2 million for 60 vehicles, or €33,333 per vehicle. Based on historical exchange rates, this equates to a price of UAH 242,000 per vehicle. Two years later, the Ministry of Emergency Situations paid Lakshmi Avto UAH 799,000, or approximately €80,000, per vehicle. The PANAX contract added no more than €740 of value per vehicle.<sup>56</sup>

The loss to the government—that is, the difference between the price that the Ministry paid and the price that ISS Ukraina paid two years earlier—is approximately UAH 15 million. The Ministry paid Lakshmi Avto in full in December 2009.<sup>57</sup>

Contract Date	Purchaser	Seller	Units	Price per unit €	Price per unit UAH	Total price for 27 vehicles in UAH
01-Nov-07	ISS Ukraina	Legal Business Consultants Ltd.	60	€ 33,333	UAH 242,000	6,534,000.00
20-Nov-09	Ministry of Emergency Situations	Lakshmi Avto	27	€80,000	UAH 799,000	21,573,000.00
Price Difference						15,039,000.00

<sup>53</sup> Exhibit 50: UA0000358.

<sup>54</sup> UA0000408 (cited above as Exhibit 19).

<sup>55</sup> UA0000420-UA0000422 (cited above as Exhibit 20).

<sup>56</sup> UA0000452 (cited above as Exhibit 10).

<sup>57</sup> Exhibit 51: UA0000460.

#### **D. The Vehicles Remain Substantially Unused**

The vehicles were delivered to various regions in Kyiv, and visits to sites where vehicles were located in the Kyiv Region were conducted in June 2010 during the course of the investigation. The vehicles at the visited locations appeared to be unused or used only infrequently. One vehicle was stored in the garage in the back lot of a fire station. The exterior and interior of the vehicle appeared to be new and unused, and the vehicle had been driven only 179 kilometers. The firemen were not familiar with operating the vehicle and could not open the hood of the car. Basic medical equipment such as a stretcher and defibrillator was stored in the back of the vehicle, bearing PANAX's mark. A second vehicle, which was received on December 22, 2009, had only been driven three times, a total of 371 kilometers.<sup>58</sup> Five other similar vehicles were also parked at the depot along with the Renault *Master*. A third vehicle's odometer had logged 1340 kilometers.

#### **IV. Conclusions and Recommendations**

In sum, the Ministry of Emergency Situations purchased 27 vehicles at a grossly inflated price, after the vehicles had been transferred among multiple related companies. The company that won the contract to supply the vehicles managed to submit a bid that was nearly identical to the confidential amount that the Ministry had budgeted. The evidence strongly suggests that the supply of emergency vehicles was a sham transaction designed to allow private individuals and corporations to profit at the public's expense.

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<sup>58</sup> Site visit and interview of confidential source, June 30, 2010.

The evidence gathered during this investigation suggests that greater regulation of the public procurement and government contracting processes is needed to promote transparency and prevent bidders from conspiring to fix the bidding or gaining access to confidential Ministry information. Ministry officials and tender committee members should perform comprehensive due diligence before embarking upon the tender process to evaluate the need for particular goods and during the tender process to investigate all bidders. Additional review by these individuals might have revealed that the cost estimate set forth by certain Ministry officials was well above the market rate, or that Lakshmi Avto had the characteristics of a shell company with which the Government would not want to deal.



# INVESTIGATION RELATING TO PROCUREMENT OF SUGAR BY THE STATE MATERIAL RESERVE

## Table of Contents

<b>I.</b>	<b>Introduction.....</b>	<b>42</b>
<b>II.</b>	<b>Executive Summary .....</b>	<b>42</b>
<b>III.</b>	<b>Investigative Findings.....</b>	<b>44</b>
	(a) <b>Terms of Contract Brokered on Behalf of Ukrresources Were Not</b>	
	<b>Favorable .....</b>	<b>45</b>
	(i) <i>Sugar Was Purchased on Kyiv Exchange at High Price to Replenish Reserves.....</i>	<i>45</i>
	(ii) <i>Prepayment Was Made on the Entire Contract Amount .....</i>	<i>49</i>
	(b) <b>Hermes-Trade LLC Contracted With Closely Related Entity, Heritage</b>	
	<b>Capital Investments LLP, for Supposed Supply of Sugar.....</b>	<b>50</b>
	(i) <i>Hermes-Trade LLC .....</i>	<i>51</i>
	(ii) <i>TIM Enterprises LLP .....</i>	<i>52</i>
	(iii) <i>Rotherton Investments Ltd. ....</i>	<i>52</i>
	(iv) <i>Heritage Capital Investments LLP.....</i>	<i>53</i>
<b>IV.</b>	<b>Conclusions and Recommendations.....</b>	<b>55</b>

## **I. Introduction**

This report details a transaction by which sugar was purchased for the State Material Reserve at a high price and has not been delivered more than six months after payment in full.

The investigation conducted with respect to this report is governed by the following sections of the Terms of Reference:

- Preservation and use of the state property, management of material reserve, financial and economic activity of state authorities and public sector entities. Terms of Reference I.2.
- Public procurement of goods, works and services and compliance with generally prescribed competitive procedures. Terms of Reference I.4.
- Evaluation with respect to compliance with the legislation of Ukraine, international law and practice in all areas set out in these Terms of Reference. Terms of Reference II.
- Conclusion on impact of discovered violations on the state economy. Terms of Reference II.
- Proposals regarding specific measures for improvement of the financial and economic situation in the state. Terms of Reference II.

## **II. Executive Summary**

In a largely failed attempt to stabilize sugar prices in 2009, the Cabinet of Ministers issued decrees ordering the Derzhkomreserve (“DKR”) to sell sugar from the State Material Reserve to retailers. DKR, through the state-owned enterprise

Resurspostach, sold a total of 37,900 tons for UAH 132.6 million, or UAH 3,600 per ton, in August and September 2009.

In July 2009, one month before DKR contracted with Resurspostach to sell the sugar, DKR entered into a contract with state-owned enterprise Ukrresources, whereby Ukrresources would buy sugar on DKR's behalf to replenish the reserves. Ukrresources often served as DKR's broker to facilitate purchases on commodities exchanges. In this particular instance, Ukrresources purchased 22,150 tons of sugar from a Ukrainian company called Hermes-Trade LLC in February 2010.

Ukrresources bought the sugar when the price was highest, several months after DKR's sale of the reserves and Ukrresources' contract with DKR to acquire goods for the material reserve. DKR's broker at Ukrresources purchased on the Kyiv Agro-Industrial Exchange, rather than the Ukraine Agricultural Exchange as was typical. Hermes-Trade's offer to sell was the only one made that day. DKR entered into two contracts with Hermes-Trade, dated February 17 and 18, 2010, to purchase a total of 22,150 tons of sugar at the price of UAH 11,000 per ton – for a total contract value of more than UAH 243 million. According to a DKR price sheet, the average price for sugar in February 2010 was UAH 8,500 per ton, and prices have fallen since.

Just one week prior, on February 10, 2010, Hermes-Trade contracted with a UK entity called Heritage Capital Investments for the supply of 60,000 tons of cane sugar from Brazil at \$590 per ton CIF (approximately UAH 4,705). A test of 3,000 tons of the sugar delivered to date reveals that instead of cane sugar, it is in fact Ukrainian beet sugar.

This raises questions as to the nature and purpose of the Hermes/Heritage contract and whether it has been fulfilled or was ever intended to be fulfilled.

Moreover, Hermes-Trade and Heritage Capital are closely linked. Hermes-Trade was bought by a Scottish company, TIM Enterprises, in December 2009. TIM Enterprise's general partner is Rotherton Investments Ltd., a company registered in the British Virgin Islands. TIM was incorporated in September 2009 at the same address in Edinburgh as Heritage Capital Investments. Rotherton Investments Ltd. (the general partner of TIM Enterprises, which now owns Hermes-Trade) was incorporated in June 2009 by Hanan Gold, an Israeli lawyer. The minutes of a meeting of the shareholders of TIM Enterprises memorializing the purchase of Hermes-Trade indicate that the meeting took place at the same address as Gold's Tel Aviv law firm. Despite Gold's ties to Hermes-Trade, he also signed the contract on behalf of Heritage Capital Investments. Furthermore, media reports suggest that the individual who was director of Hermes-Trade until one week prior to the transaction with DKR is a former employee of Resurspostach, which works closely with the DKR.

The DKR prepaid for all of the sugar in March 2010, which, while permissible, is unusual. The contracts between DKR and Hermes-Trade provided that delivery was to occur within 90 days of payment, which was completed by March 23, 2010. As of August 2010, only approximately 5,000 tons of sugar had/have been delivered. The DKR has initiated legal proceedings against Hermes-Trade for its breach of the contract by failing to deliver the sugar within three months of payment. More than UAH 188 million (or US\$23 million) worth of sugar remains undelivered, and Hermes-Trade can maximize

its gains by providing sugar several months after the contract date as the price continues to decline.

### **III. Investigative Findings**

#### **A. Terms of Contract Brokered on Behalf of Ukrresources Were Not Favorable**

In 2009, the Government attempted to stabilize domestic retail prices of sugar by releasing thousands of tons of sugar from the State Material Reserve. On July 1, 2009, the Cabinet of Ministers issued Decree No. 722 signed by former Prime Minister Yulia Tymoshenko ordering DerzhKomReserve (“DKR”), the government entity that administers the State Material Reserve, to sell 10,000 tons of sugar from the reserves to retailers.<sup>1</sup> Decree No. 722 instructed the DKR to replenish the sugar reserves with sugar made from sugar beet harvested in 2009 at least in the amount specified in the decree. On August 12, 2009, the Cabinet of Ministers passed Resolution No. 952-r, directing DKR to sell an additional 28,000 tons of sugar on the domestic market.<sup>2</sup> The August 12 decree was also signed by Tymoshenko. An earlier decree dated February 4, 2009 specified that the DKR should sell the reserve sugar at minimum price of UAH 3,125 before the 20 percent value-added tax (or UAH 3,750 with VAT).<sup>3</sup>

To facilitate the sale of the sugar, DKR signed a series of Commission Agreements with state-owned enterprise Resurspostach.<sup>4</sup> One such contract, which was dated August 17, 2009, provided that Resurspostach would sell the sugar at the price of

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<sup>1</sup> Exhibit 52: UA0001382.

<sup>2</sup> Exhibit 53: UA0001383.

<sup>3</sup> Exhibit 54: UA0001384.

<sup>4</sup> The investigative team has been provided with only one of the agreements.

UAH 3,500, which included VAT, plus expenses and a 2 percent “trade mark-up.”<sup>5</sup> Other contracts were undated. Resurspostach sold a total of 37,900 tons for a total price of UAH 132.6 million, or UAH 3,600 per ton.<sup>6</sup>

1. *Sugar Was Purchased on Kyiv Exchange at High Price to Replenish Reserves*

Even before the sugar was sold, the DKR turned its attention to replenishing the reserves. On July 14, 2009, DKR entered into a contract with state enterprise Ukrresources to purchase sugar to replenish the material reserve.<sup>7</sup> Pursuant to the contract, Ukrresources was to act as DKR’s broker in procuring unspecified “assets” for the state reserve on the Ukraine Agricultural Exchange. The contract incorporated by reference the terms of Cabinet of Ministers Decree No. 667, dated July 1, 2009.<sup>8</sup> Decree No. 667 stipulated that the procurement of commodities for the State Material Reserve in 2009 and 2010 should be conducted by making purchase contracts on accredited commodity exchanges (that is, as opposed to a tender process). That decree also provided that the purchase price of the goods would be determined on the Agricultural Exchange, subject to certain minimum and maximum prices designated by the Government. The agreement between DKR and Ukrresources was to be effective until December 31, 2009.

However, an amendment to the July 14 agreement, which was dated December 14, 2009, eliminated the reference to boundaries for pricing and allowed the Ukrresources broker to register with and enter into contracts on other accredited exchanges in addition

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<sup>5</sup> Exhibit 55: UA0001385, UA0001388.

<sup>6</sup> KRU provided this figure, but the investigative team has not located independent support for it.

<sup>7</sup> Exhibit 56: UA0003879.

<sup>8</sup> Exhibit 57: UA0003399.

to the Ukraine Agricultural Exchange.<sup>9</sup> The amendment also eliminated the December 31 deadline and provided that the agreement would remain effective until both parties had fully performed. The day after the agreement was amended, Ukrresources registered as a broker on the Kyiv Agro-Industrial Exchange.<sup>10</sup>

Seven months after Ukrresources and DKR executed their July 14 agreement – and when market prices were at their peak – Ukrresources set out to replenish the sugar reserves. The Ukrresources broker turned to the smaller Kyiv Agro-Industrial Exchange to facilitate the sugar purchase. According to unnamed sources, it was unusual for a sugar trade to take place on the Kyiv exchange, which handles between one and ten exchanges per day, approximately 90 percent of which are wheat trades.<sup>11</sup> Another source could not recall any other purchases made by the DKR on the Kyiv exchange.<sup>12</sup> On February 17, 2010, the day that Ukrresources went to the Kyiv exchange, only one offer to sell sugar was made, by Hermes-Trade LLC, and the trade was the only sugar trade that took place that day.

Consequently, Ukrresources brokered two contracts, dated February 17 and 18, 2010, between DKR and Hermes-Trade, a Ukrainian company. The price that the parties agreed upon was UAH 11,000 per ton, including VAT. DKR would purchase 20,000 tons under the February 17 contract<sup>13</sup> and 2,150 tons under the February 18 contract,<sup>14</sup> for a total volume of 22,150 tons of sugar and a total purchase price of UAH 243.65 million,

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<sup>9</sup> Exhibit 58: UA0003881.

<sup>10</sup> Exhibit 59: UA0003470; Exhibit 60: UA00003472.

<sup>11</sup> Interviews of confidential sources, August 17 and 19, 2010.

<sup>12</sup> Interview of confidential source, August 10, 2010.

<sup>13</sup> Exhibit 61: UA0002954.

<sup>14</sup> Exhibit 62: UA0002956.

including VAT. This price was 22.7 percent higher than the market price.<sup>15</sup> The average market price for sugar in February 2010 was UAH 8,500 per ton, and the price per ton in the months following DKR's sale of the sugar remained lower than at the time of the Hermes-Trade transaction. Furthermore, documents provided in response to the Prosecutor General's inquiries showed that competitors could have provided sugar in February 2010 at prices of UAH 8,350, UAH 6,820, and UAH 5,953 per ton, including VAT.<sup>16</sup> A source stated that DKR monitors commodity prices on a monthly basis but relied on "internet research" in agreeing to the price of UAH 11,000 per ton.<sup>17</sup>

Both contracts provided for delivery three months after the execution of the respective agreement – that is, May 17 and 18, 2010. Payment was to occur following receipt of an invoice but prior to receipt of the goods. However, on March 19, 2010, the second contract was amended,<sup>18</sup> and delivery instead was to occur three months from the date of payment, which took place on March 22 and 23. Sources interviewed could not provide an explanation for the amendment.

Both the DKR and Hermes-Trade were represented at the Exchange by brokers. The DKR was represented by I.I. Lyutyi of Ukrresources, and Hermes-Trade by BrokBiznesTsent LLC.<sup>19</sup> The commission agreements between Hermes-Trade and BrokBiznesTsent were dated February 17 and 18, 2010 and authorized the broker to enter into exchange contracts at the Kyiv Agro-Industrial Exchange for the sale of "sugar of foreign production" in the amounts and values specified in the contracts between

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<sup>15</sup> Exhibit 63: UA0003401; interview of confidential source, August 10, 2010.

<sup>16</sup> Exhibit 64: UA0003990; Exhibit 65: UA0003992; Exhibit 66: UA0003993.

<sup>17</sup> Interview of confidential source, August 10, 2010.

<sup>18</sup> Exhibit 67: UA0002956-0004.

<sup>19</sup> Exhibit 68: UA0003394, UA0003396 ; *see also* Exhibit 69: UA0003480.



Hermes-Trade and DKR. The commission agreements stated that the contracts should include a term of delivery until December 31, 2010, which contradicts the original delivery dates of May 17 and 18, 2010 in the contracts between DKR and Hermes-Trade. The individual broker at Ukrresources, I.I. Lyutyi, has been dismissed since the sugar transaction.<sup>20</sup>

2. *Prepayment Was Made on the Entire Contract Amount*

DKR agreed to make advance payment to Hermes-Trade of the full contract amount. DKR paid Hermes-Trade the total amount due, UAH 243.65 million, in 27 installments between February 24 and March 23, 2010. Each transfer was no more than UAH 10 million.<sup>21</sup> Despite DKR's complete performance under the contract, Hermes-Trade has delivered only 5,000 tons of sugar. Pursuant to the terms of the contract, delivery of the sugar was required within three months of payment. An initial 3,000 tons were delivered only after DKR instituted legal proceedings against Hermes-Trade and the court began scheduling hearings. An additional 2,000 tons were subsequently delivered. Hermes-Trade has promised to deliver the sugar after new crops are harvested in September and October 2010.<sup>22</sup> Cabinet of Ministers Decree No. 722 specified that the sugar used to replenish the reserves should be made from sugar beet harvested in 2009.

A total of 16,500 tons remain undelivered, for a total loss of UAH 188.65 million (not including the inflated price paid by DKR). The continued delays in the delivery of sugar increases Hermes-Trade's profits, as the market price of sugar has declined since

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<sup>20</sup> The Investigative Firms were unable to interview Mr. Lyutyi and was informed that he has fled the country.

<sup>21</sup> Exhibit 70: UA0002933; Exhibit 71: UA0002919; Exhibit 72: UA0002921.

<sup>22</sup> Interview of confidential source, August 17, 2010.

February. For example, according to DKR's research, the average price per ton was UAH 8,175 in March and UAH 7,500 in April.

Although the legality of the prepayment made by DKR was questioned by some, it appears that this may have been permissible. On October 9, 2006, the Cabinet of Ministers issued Decree No. 1404,<sup>23</sup> which prescribed certain goods and services for which government departments were allowed to pay in advance of receipt. Subsequently, the Cabinet issued a secret decree, No. 190-2, on March 12, 2008.<sup>24</sup> That decree primarily related to the stabilization of meat prices but also amended Decree No. 1404 to provide that prepayment could be made on any goods maintained by the State Material Reserve. Nevertheless, sources said that the prepayment was unusual and could not cite other contracts in which prepayment was made.<sup>25</sup> Media reports also suggested that officials of Hermes-Trade were formerly employed by DKR and/or Resurspostach.

**B. Hermes-Trade LLC Contracted With Closely Related Entity, Heritage Capital Investments LLP, for Supposed Supply of Sugar**

One week before its exchange with the State Material Reserve, Hermes-Trade entered into a contract with a UK entity called Heritage Capital Investments LLP for the supply and importation of sugar.<sup>26</sup> The February 10, 2010 agreement provided that Hermes-Trade would purchase 60,000 tons of Brazilian cane sugar for a total of US\$35.4 million, or US\$590 (approximately UAH 4,826 using historical exchange rates) per ton.

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<sup>23</sup> Exhibit 73: UA0005040.

<sup>24</sup> The investigative team did not view the decree due to its "secret" classification; the understanding of this document conveyed here is based on discussions with confidential sources, including on August 10 and September 3, 2010.

<sup>25</sup> Interview of confidential source, August 17, 2010.

<sup>26</sup> Exhibit 74: UA0003410; however, note that this document is incomplete.

Therefore, the total contract value was US\$35.4 million or UAH 289.6 million – strikingly similar to the total value of the contract between DKR and Hermes-Trade.

There is no evidence that the contract between Hermes-Trade and Heritage Capital has been fulfilled, and the Investigative Firms questioned whether the contract was ever intended to be fulfilled or instead was one element in the apparent scheme to transfer funds from the State Material Reserve to private hands.<sup>27</sup> The supposed Brazilian supplier of the sugar was not identified. Hermes-Trade did not possess a license to import sugar in the period between January 1 and April 9, 2010.<sup>28</sup> There is no evidence that Heritage has provided sugar to Hermes-Trade. Moreover, the limited quantity of sugar that has been received and tested by DKR is Ukrainian beet sugar, not imported cane sugar as specified in the contract between Heritage and Hermes-Trade.<sup>29</sup> The close connections between Hermes-Trade and Heritage Capital Investments further supports that the contract between those two entities was not at arm's length.

1. *Hermes-Trade LLC*

Hermes-Trade was incorporated on September 18, 2008 in Ukraine, listing its business purpose as “wholesale trading with meat and meat products” and wholesale or retail transactions involving food and non-food items.<sup>30</sup> The company's current director is Volodimir Oleksandrovich Berson. Berson was elected as director at a Hermes shareholder meeting that took place on February 10, 2010.<sup>31</sup> Volodimir Kolga served as

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<sup>27</sup> That is, Hermes-Trade may have been able to point to this apparently sham contract with Heritage Capital as evidence that Hermes-Trade could fulfill its contract with the DKR.

<sup>28</sup> Exhibit 75: UA0003994.

<sup>29</sup> Interview of confidential source, August 17, 2010.

<sup>30</sup> Exhibit 76: UA0003406.

<sup>31</sup> Exhibit 77: UA0003404.

director before Berson. According to media reports, Kolga worked for state enterprise Resurspostach, which deals closely with DKR, between 2007 and 2008.<sup>32</sup> The Ukrainian corporate registry identified the founder of Hermes as a UK company named T.I.M. Enterprises.

2. *TIM Enterprises LLP*

TIM Enterprises LLP ("TIM"), a limited partnership, was incorporated on September 25, 2009. The company's registered address is 133 Fountainbridge, Edinburgh EH3 9BA, United Kingdom.<sup>33</sup> At TIM's December 14, 2009 shareholder meeting, the decision was made to purchase Hermes-Trade.<sup>34</sup> The meeting took place at 28 Ahah Ha'am, Tel-Aviv, Israel. M.Fridman-H.Gold & Co., the law firm of Israeli attorney Hanan Gold, has an office at the same address. TIM is controlled by its general partner and 99.9 percent shareholder, Rotherton Investments Ltd. Rotherton Investments was the sole participant at the December 14 meeting and was represented by Hanan Gold as director.

3. *Rotherton Investments Ltd.*

Rotherton Investments was incorporated by Hanan Gold on June 26, 2009 in the British Virgin Islands. Gold is identified as a director of Rotherton. Rotherton's office address is listed as 28 Ahah Ha'am, Tel-Aviv, Israel, the same address as Gold's law firm, M.Fridman-H.Gold & Co.

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<sup>32</sup> Exhibit 78: UA0005044.

<sup>33</sup> Exhibit 79: UA0003412.

<sup>34</sup> Exhibit 80: UA0003408.

4. *Heritage Capital Investments LLP*

Gold also served as a representative of Heritage Capital Investments LLP and has held power of attorney to act on Heritage's behalf as of February 1, 2010. Gold signed the February 10 contract between Heritage and Hermes-Trade on Heritage's behalf, despite his ties to Hermes-Trade through TIM and Rotherton, and was therefore involved on both sides of the transaction. UK corporate records show that Heritage, a limited partnership, was incorporated on October 1, 2009. The company's registered address is 133 Fountainbridge, Edinburgh EH3 9BA, United Kingdom – the same address as TIM Enterprises.

Heritage Capital's general partner is another company incorporated in the British Virgin Islands, Peacebridge Intertrade Inc., and its limited partner is an individual in Panama. Peacebridge Intertrade was incorporated on June 26, 2009 – the same date as Rotherton Investments. There is no legitimate explanation for these complicated offshore structures or the coincidence of dates and addresses of incorporation. The corporate relationships described above are illustrated in the chart on the following page.



#### **IV. Conclusions and Recommendations**

In sum, the DKR paid an above-market price for the sugar, and the vast majority of the total amount has not yet been delivered, six months after payment in full. The evidence gathered in this investigation suggests that greater regulation of the Government procurement processes is needed to promote transparency, monitor brokers and enterprises that the Government engages to act on its behalf, and prevent contracting parties and individuals within government-related entities from colluding to structure transactions for their own private benefit. The State Material Reserve should perform comprehensive due diligence on corporations with which they intend to deal, to ensure that these companies will be able to perform under the contract, and to check that the company does not have problematic government ties or conflicts of interest, before signing a contract and transferring payment. Government departments should also exhibit stronger negotiating power, for example, by insisting on delivery before payment is made and by thoroughly understanding fair market prices. Finally, closer monitoring of officials and employees is required to ensure internal compliance and good practices.

# **INVESTIGATION RELATING TO USE OF FUNDS RECEIVED FROM THE SALE OF CARBON CREDITS PURSUANT TO THE KYOTO PROTOCOL**

## **Table of Contents**

<b>I.</b>	<b>Introduction.....</b>	<b>57</b>
<b>II.</b>	<b>Executive Summary.....</b>	<b>57</b>
<b>III.</b>	<b>Overview of Carbon Emission Trading Under The Kyoto Protocol.....</b>	<b>59</b>
<b>IV.</b>	<b>Investigative Findings.....</b>	<b>60</b>
	<b>A. Ukraine Received €320 Million From The Sale of Carbon Emission Credits in 2009.....</b>	<b>60</b>
	1. <i>International Contracts Mandated That The Funds Be Placed In Specially Designated Accounts And Be Used Exclusively For Greening Activities .....</i>	<i>61</i>
	<b>B. In 2009, Pursuant to the Orders of Former Prime Minister Tymoshenko, Ukraine Removed Kyoto Funds From The Kyoto Accounts In Violation of International Contracts and Ukraine's Budget Code.....</b>	<b>62</b>
	1. <i>July 6 Transfer to Interest Bearing Account .....</i>	<i>63</i>
	2. <i>On July 15, 2009, The Prime Minister Ordered the State Treasury to Transfer €80 Million of the Kyoto Funds Into The Pension Fund .....</i>	<i>64</i>
	3. <i>On September 10, 2009, Prime Minister Tymoshenko Ordered the State Treasury to Transfer €200 Million of the Kyoto Funds Into The Pension Fund.....</i>	<i>66</i>
	4. <i>On October 5, 2009, Prime Minister Tymoshenko Ordered the State Treasury To Transfer €90 Million of the Kyoto Funds Into Naftogaz Accounts So That Naftogaz Could Pay OAO Gazprom .....</i>	<i>68</i>
<b>V.</b>	<b>Conclusions and Recommendations.....</b>	<b>71</b>



## **I. Introduction**

This report details the former Prime Minister's and former Cabinet of Ministers' inappropriate and unlawful use of €320 million received from the sale of carbon emission credits pursuant to the Kyoto Protocol.

The investigation conducted herein is governed by the following sections of the Terms of Reference:

- Public finance, performance of the state budget in respect of revenues and expenditures, formation of public debt, and payments under debt obligations, substantiation of granting loans guaranteed by the Government and their repayment in full, utilization of funds for recapitalization of banking system, management of mandatory state social insurance funds. Terms of Reference I.1.
- Evaluation with respect to compliance with the legislation of Ukraine, international law and practice in all areas set out in these Terms of Reference. Terms of Reference II.
- Conclusion on impact of discovered violations on the state economy. Terms of Reference II.
- Proposals regarding specific measures for improvement of the financial and economic situation in the state. Terms of Reference II.

## **II. Executive Summary**

The National Environmental Investment Agency (NEIA) of Ukraine entered into five international contracts in March, April, and November 2009 to sell 32 million assigned amount units ("AAUs" or "carbon emission credits") under the framework of

the Kyoto Protocol to the United Nations Convention on Climate Change (“Kyoto Protocol”). Ukraine received €320 million for the sale of carbon emission credits in 2009 (“Kyoto Funds”). The terms of the international contracts, required that the €320 million be maintained in separately segregated accounts (“Kyoto Accounts”) and be utilized exclusively for “Greening Activities” aimed at reducing greenhouse gases and pollution.

Instead of being used for Greening Activities, the the Kyoto Funds were used for purposes prohibited by international contracts and Ukrainian law. On three separate occasions, the former Prime Minister Yulia Tymoshenko ordered the State Treasury to transfer a significant quantity of the Kyoto Funds from the Kyoto Accounts into the General Treasury Account at the State Savings Bank of Ukraine (also known as Oschadbank of Ukraine). Each of these instructions breached the international contracts and violated the Budget Code of Ukraine:

- July 14, 2009: The former Prime Minister ordered the Ministry of Finance to transfer €180 million (UAH 1.92 billion) from the Kyoto Accounts to the General Treasury. The money was transferred on July 15, 2009 and converted into hryvnias. Between July 15 and 17, 2009, UAH 1.68 billion was then transferred from the General Treasury Account to the Pension Fund. These funds were returned to the Kyoto Accounts after Ukraine received additional funds from the IMF.
- September 10, 2009: The former Prime Minister ordered the Ministry of Finance to transfer €200 million (UAH 2.3 billion) from the Kyoto Accounts to the General Treasury. The money was transferred on September 11, 2009. From

September 14-18, 2009, UAH 2.3 billion was transferred from the General Treasury Account to the Pension Fund. These funds have not been returned to the Kyoto Accounts.

- October 5, 2009: The former Prime Minister ordered the Ministry of Finance to transfer the remaining €90 million to The State Export Import Bank of Ukraine (“Ukreximbank”) to provide liquidity on a line of credit held by Naftogaz. The funds were returned to the Kyoto Accounts in May, 2010.

As a result of these unlawful actions, none of the €320 million received through the sale of carbon emission credits had been used on projects aimed at reducing greenhouse gas emissions as of the end of 2009. These actions have jeopardized Ukraine’s ability to sell carbon emission credits in the future and exposed the country to significant legal liabilities. Moreover, the Greening Projects, if undertaken, would create significant new employment opportunities for the people of Ukraine during a time of financial crisis. Instead, the Government sacrificed job creation in order to mask deficits in the Pension Fund and exposed the country to significant legal liabilities.

### **III. Overview of Carbon Emission Trading Under The Kyoto Protocol**

The United Nations Framework Convention on Climate Change (UNFCCC) is the preeminent international treaty aimed at reducing global warming.<sup>1</sup> Ukraine ratified the UNFCCC on May 13, 1997. The Kyoto Protocol is an international agreement linked to the UNFCCC that establishes legally enforceable, binding limits on Greenhouse Gas

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<sup>1</sup> See [http://unfccc.int/essential\\_background/items/2877.php](http://unfccc.int/essential_background/items/2877.php)

Emissions on its signatories.<sup>2</sup> Each signatory to the agreement must reduce its emissions by a pre-determined amount on a yearly basis. Ukraine ratified the Kyoto Protocol on April 12, 2004, and it entered into force on February 16, 2005.<sup>3</sup> Article 17 of the Kyoto Protocol allows parties to the agreement to participate in emissions trading to fulfill their carbon emission reduction commitments under Article 3 of the Kyoto Protocol. Carbon emissions trading allows countries that are under their emissions limit to sell excess capacity to countries over their emissions limit.

#### **IV. Investigative Findings**

##### **A. Ukraine Received €320 Million From The Sale of Carbon Emission Credits in 2009**

Ukraine was under its emission limit in 2009 whereas Japan and Spain exceeded their respective limits. Consequently, between March and November 2009, the NEIA entered into four agreements<sup>4</sup> with Japanese companies and one agreement with Spain for the sale of carbon emission credits. Ukraine sold a total of 32 million carbon emission credits pursuant to these agreements in 2009 and earned €320 million (each carbon emission credit is valued at €10), as summarized below.<sup>5</sup>

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<sup>2</sup> Exhibit 81: UA0005807.

<sup>3</sup> Exhibit 82: UA0000585; Exhibit 83: UA0005935

<sup>4</sup> Exhibit 84: UA0000586; Exhibit 85: UA0000617; Exhibit 86: UA0000645; Exhibit 87: UA0000672; Exhibit 88: UA0000698.

<sup>5</sup> Parties with commitments under the Kyoto Protocol have accepted targets for limiting or reducing emissions. These targets are expressed as levels of allowed emissions over the 2008-2012 commitment period.

### Funds Received from the Sale of AAU's

Date of Agreement	Buyer	Country	Number of AAUs	Date Funds Received	Total Received (€s)
18-Mar-09	New Energy and Industrial Technology Development Organisation	Japan	15,000,000	22-April-09	150,000,000
19-Mar-09	Tohoku Electric Power Co., Inc	Japan	5,000,000	27-April-09	50,000,000
19-Mar-09	Tohoku Electric Power Co., Inc	Japan	8,000,000	19-May-09	80,000,000
27-Apr-10	Chubu Electric Power Co., Inc	Japan	1,000,000	3-June-09	10,000,000
25-Nov-09	Ministerio de Medio Ambiente	Spain	3,000,000	31-Dec.-09	30,000,000

1. *International Contracts Mandated That The Funds Be Placed In Specially Designated Accounts And Be Used Exclusively For Greening Activities*

The terms of each contract stipulate that monies earned from the sale of carbon emission credits must be used by Ukraine on “Greening Activities,” defined as “projects, measures and other activities for the reduction or limitation of greenhouse gas or pollution in Ukraine, as well as other projects, measures and activities aimed at fulfilling [Ukraine’s] commitments under the Kyoto Protocol.”<sup>6</sup> Greening Activities include projects aimed at energy conservation, switching to cleaner fuel sources, renewable energy, utilization of coal bed methane and pollution reduction.<sup>7</sup> Moreover, each contract requires the funds be maintained in segregated accounts.<sup>8</sup> The international contracts also require that the NEIA consult with its counterparties in selecting Greening Activities.<sup>9</sup> The State Budget of Ukraine also requires that funds earned from the sale of

<sup>6</sup> See Exhibits 84-88, above: UA0000586, at p.5, UA0000617. at p.5, UA0000645, at p. 5, UA0000672, at p.5, UA0000698, at p. 5.

<sup>7</sup> See Exhibits 84-88, above: UA0000586, at 4.1, UA0000617. at 4.1, UA0000645, at 4.1, UA0000672, at 4.1, UA0000698, at 4.1.

<sup>8</sup> See Exhibits 84-88, above.

<sup>9</sup> See *id.*

AAUs be utilized on Greening Activities.<sup>10</sup> The funds cannot be used contrary to Ukrainian law.<sup>11</sup>

The funds received from the sale of AAUs were deposited in specifically designated accounts (the Kyoto Accounts) held at Ukreximbank in the name of the State Treasury of Ukraine.<sup>12</sup>

**B. In 2009, Pursuant to the Orders of Former Prime Minister Tymoshenko, Ukraine Removed Kyoto Funds From The Kyoto Accounts In Violation of International Contracts and Ukraine's Budget Code**

During the course of 2009, a total of 580m was withdrawn from the Kyoto Accounts, €200 million of which has not been returned. These withdrawals include:

- 110 million transfer on deposit to an interest earning account in July 2009;
- 180 million in July 2009 at the instruction of the Prime Minister;
- 200 million in September 2009 at the instruction of the Prime Minister;
- 90 million in October 2009, later transferred to a bank at the direction of the Prime Minister.

In the case of the €180 million and €200 million transfers, the Kyoto Funds were converted into hryvnias and deposited in Treasury accounts held at the National Bank of Ukraine, in order to provide liquidity to the Treasury to meet payments due. The €200 million withdrawn in September remains outstanding.

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<sup>10</sup> Exhibit 89 : UA0000728

<sup>11</sup> See Exhibits 84-88, section 2.5(i).

<sup>12</sup> Exhibit 90: UA0003035; Exhibit 91: UA0003037; Exhibit 92: UA0003039; Exhibit 93: UA0003041; Exhibit 94: UA0003043; Exhibit 95: UA0003045.

The following schedule summarizes the activities on the Kyoto accounts; the details of which are discussed below:

	Date	004- Account for Tohoku Elec. Power Co.	802- Account for Tohoku Elec. Power Co.	701-Account for New Energy & Industrial Tech. Dev. Org.	903- Account for Chubu Elec. Power Co.	206 -- Account for Ministerio de Medio Ambiente	Total
Balance		80,000,000	50,000,000	150,000,000	10,000,000	0	290,000,000
Transfer to Deposit	06/07/09			-110,000,000			- 110,000,000
Balance		80,000,000	50,000,000	40,000,000	10,000,000	0	180,000,000
Conversion	15/07/09	-80,000,000	-50,000,000	-40,000,000	-10,000,000		- 180,000,000
Balance		0	0	0	0	0	0
Return of Trf to Deposit	05/08/09			110,000,000			110,000,000
Balance		0	0	110,000,000	0	0	110,000,000
Return of Conversion	05/08/09	80,000,000	50,000,000	40,000,000	10,000,000		180,000,000
Balance		80,000,000	50,000,000	150,000,000	10,000,000	0	290,000,000
Conversion	11/09/09		-50,000,000	-150,000,000			- 200,000,000
Balance		80,000,000	0	0	10,000,000	0	90,000,000
Transfer to Deposit	06/10/09	-80,000,000			-10,000,000		-90,000,000
Balance		0	0	0	0	0	0
Deposit	31/12/09					30,000,000	30,000,000
Balance		0	0	0	0	30,000,000	30,000,000
Return of Trf to Deposit	05/05/10	80,000,000			10,000,000		90,000,000
Balance		80,000,000	0	0	10,000,000	30,000,000	120,000,000

1. *July 6 Transfer to Interest Bearing Account*

On July 6, 2009, €110 million was transferred from Kyoto Account 701 to a Treasury Account held at Oschadbank, the State Savings Bank of Ukraine. The transfer

was made at the instruction of the Ministry of Finance<sup>13</sup> and pursuant to a deposit agreement between the Treasury and Oschadbank.<sup>14</sup> According to the terms of the deposit agreement, the sum of €110 million was to be held in an interest-bearing deposit account until August 6, 2009. The €110 million was returned to the Kyoto Account at Ukreximbank on August 5, 2009.<sup>15</sup>

2. *On July 15, 2009, The Prime Minister Ordered the State Treasury to Transfer €180 Million of the Kyoto Funds Into The Pension Fund*

A total of €180m was transferred by the State Treasury from the Kyoto Accounts on July 15, 2009 and converted into hryvnias through the National Bank of Ukraine. The conversion was undertaken in accordance with the order of then-Prime Minister Y. Tymoshenko, No. 1191-ДЧК, dated July 14, 2009 and marked for internal use only.

On July 14, 2009 the National Bank of Ukraine completed application No. 14-09/2252<sup>16</sup> for the sale of foreign currency, accompanied by payment orders No. 275, 276, 277, 278<sup>17</sup>. The application stated that the 180 million would be deposited into the General Treasury account 47401992701 at the National Bank of Ukraine for sale, at a minimum exchange rate of 10.655099 UAH/Euro. The funds were transferred from the Kyoto accounts held at Ukreximbank on July 14, 2009 in the following amounts:

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<sup>13</sup> Exhibit 96: UA0000730.

<sup>14</sup> Exhibit 97: UA0003310.

<sup>15</sup> Exhibit 98: UA0003051.

<sup>16</sup> Exhibit 99: UA0003328.

<sup>17</sup> Exhibit 100: UA0000782; Exhibit 101: UA0000783; Exhibit 102: UA0000784; Exhibit 103: UA0000785.



	Amount in Euros	Amount in UAH
2513004004489	80,000,000	853,607,680
2513802004489	50,000,000	533,504,800
2513701004489	40,000,000	426,803,840
2513903004489	10,000,000	106,700,960
	180,000,000	1,920,617,280
Less: Commission of 0.05%		-960,308.64
		1,919,656,971

The transferred funds were deposited in account 47401992701, before being converted into UAH at a rate of 10.670096.<sup>18</sup> On July 15, 2009 the converted amount of UAH 1,919,656,971.36 was transferred to Treasury Account 311290106 from account 47401992701.<sup>19</sup> The National Bank of Ukraine was paid commission for handling the conversion, which amounted to 0.05% of the converted sum or UAH 960,308.64.

The €180 million converted into UAHs was used by the Treasury to assist the Unified Registry of Treasury Funds in meeting payments due, particularly funds required by the Pension Fund of Ukraine. On July 15, 16, and 17, 2009 the Pension Fund sent formal requests to the Treasury for loans to make pension payments that were due.<sup>20</sup> In response, payments totaling UAH1,683,400 were made to the Pension Fund, as follows (note that the Treasury does not always transfer the full amount requested):

<sup>18</sup> Note that the exchange rate listed in Application No. 14-09/2252 is 10.655099; however the rate used in bank transfer documents is 10.670096

<sup>19</sup> Exhibit 104: UA0000786.

<sup>20</sup> Exhibit 105: UA0003316; Exhibit 106: UA0003317; Exhibit 107: UA0003318.

Date	Amount Requested by Pension Fund (UAH)	Amount Loaned to Pension Fund (UAH)
07/15/2009	551,000,000	270,000,000
07/16/2009	831,400,000	831,400,000
07/17/2009	582,000,000	582,000,000
<b>Total</b>	<b>1,964,400,000</b>	<b>1,683,400,000</b>

If the UAH 1,919,656,971.36 had not been received, the Treasury fund would have been in deficit by close of business on the July 16, 2010.<sup>21</sup>

The €180 million was returned to the Kyoto Accounts at Ukreximbank on August 5, 2010.<sup>22</sup> According to confidential sources, the Treasury was able to repay the funds to the Kyoto Accounts using recently received funds from the International Monetary Fund.<sup>23</sup>

3. *On September 10, 2009, Prime Minister Tymoshenko Ordered the State Treasury to Transfer €200 Million of the Kyoto Funds Into The Pension Fund*

A further €200 million was withdrawn by the Treasury from the Kyoto Accounts on September 10, 2009 and converted into hryvnias through the National Bank of Ukraine. The conversion was undertaken as a result of an order of the then-Prime Minister Y.Tymoshenko, No. 1049-p-ДЧК, dated September 9, 2009 and marked for internal use only.

The funds were withdrawn from the Kyoto accounts held at Ukreximbank on September 10, 2009 in the following amounts, and converted into hryvnias at a rate of 11.627855:

<sup>21</sup> Exhibit 108: UA0003049.

<sup>22</sup> Exhibit 109: UA0003055; Exhibit 110: UA0003058; Exhibit 111: UA0003061; Exhibit 112; UA0003064.

<sup>23</sup> Interviews of confidential sources, August 6, 2010.

	Amount Euros	Amount UAH
2513802004489	50,000,000	581,392,750
2513701004489	150,000,000	1,744,178,250
	200,000,000	2,325,571,000
Less: Commission of 0.05%		-1,162,785.50
		2,324,408,215

The transfer of €200 million was the result of two Payment Orders issued by Ukreximbank on behalf of the Treasury, which stated that the funds should be deposited in account 47401992701 at the National Bank of Ukraine.<sup>24</sup> On September 11, 2009 the converted amount of UAH 2,324,408,214.50 was transferred to Account No. 311290106 from Account No. 47401992701 held at the National Bank of Ukraine.<sup>25</sup> The National Bank of Ukraine was paid a commission of UAH 1.16 million for handling the conversion.

The €200 million was also used by the Treasury to assist the Unified Registry of Treasury Funds in meeting payments due, particularly funds required by the Pension Fund. On September 14-18, 2009, the Pension Fund sent formal requests to the Treasury for loans to make pension payments that were due.<sup>26</sup> In response, during the period from

<sup>24</sup> Exhibit 113: UA0000732; Exhibit 114: UA0000733.

<sup>25</sup> Exhibit 115: UA0003032.

<sup>26</sup> Exhibit 116: UA0003320; Exhibit 117: UA0003321; Exhibit 118: UA0003322; Exhibit 119: UA0003323; Exhibit 120: UA0003324.

September 14, 2009 to September 18, 2009 payments totaling UAH 2.35 billion were made to the Pension Fund, as follows:<sup>27</sup>

Date	Amount Requested by Pension Fund (UAH)	Amount Loaned to Pension Fund (UAH)
09/14/2010	965,700,000	965,700,000
09/15/2010	233,000,000	233,000,000
09/16/2010	606,700,000	606,700,000
09/17/2010	340,000,000	340,000,000
09/18/2010	200,000,000	200,000,000
<b>Total</b>	<b>2,345,400,000</b>	<b>2,345,400,000</b>

If the UAH 2.32 billion had not been received, the Treasury fund would have been in deficit by close of business on September 16, 2009. The €200 million has not been returned by the Treasury to the Kyoto Accounts.<sup>28</sup>

4. *On October 5, 2009, Prime Minister Tymoshenko Ordered the State Treasury To Transfer €90 Million of the Kyoto Funds Into Naftogaz Accounts So That Naftogaz Could Pay OAO Gazprom*

National Joint-Stock Company Naftogaz of Ukraine (“Naftogaz”) is one of the largest companies in Ukraine. It is a vertically integrated oil and gas company engaged in full cycle of operations in gas and oil field exploration and development, production and exploratory drilling, gas and oil transport and storage, and supply of natural gas to consumers. Over 90% of the oil and gas in Ukraine is produced by Naftogaz and its

<sup>27</sup> Exhibit 121: UA0003050

<sup>28</sup> The State Pension Fund regularly makes “cash calls” on the Treasury, to assist in financing pension payments due. As a result of these cash calls, the Pension Fund has accrued a significant liability with the Treasury. Although the balance of this liability varies according to amounts borrowed and repaid during the course of a year, the total due to the Treasury increased significantly during the course of 2009, largely as a result of the financial crisis. Specifically, the liability increased by 339% between January and December 2009, from UAH 5 billion on January 8, 2009 to UAH 22 billion on December 30, 2009.

affiliates. Naftogaz pipelines also transport voluminous quantities of Russian gas transiting to Europe.<sup>29</sup>

Following the September 10, 2009 withdrawal of €200 million, €90 million remained in the Kyoto Accounts. On October 5, 2009 the Cabinet of Ministers issued instruction No.1179-r, ordering the Treasury to transfer the remaining €90 million from Kyoto Accounts Nos. 2513004004489 and 2513903004489 held with Ukreximbank to Treasury Account No. 2525005004489, also at Ukreximbank.<sup>30</sup> The funds were transferred on October 6, 2009.

The Treasury and Ukreximbank entered into a deposit agreement on the same day stating that the funds were to be returned by December 7, 2009, upon which the €90 million should be returned to the respective Kyoto Accounts and any accrued interest credited to Treasury account 2513101284489.<sup>31</sup> The deposit agreement was later extended to December 30, 2009, pursuant to Cabinet of Ministers instruction 70137/1/1-09-ДЧК, dated December 8, 2009 and signed by Prime Minister Tymoshenko. On the same day, the Cabinet of Ministers issued secret instruction No.1537-r(ДЧК). This allowed the Treasury, at the discretion of the Minister of Finance, to extend the terms of bank deposit agreements for 2010, in accordance with which temporarily free state budget funds were deposited. This was to support the liquidity of the state banks, which were providing financing to state enterprises.

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<sup>29</sup>Exhibit 122: UA0005947

<sup>30</sup> Exhibit 123: UA0003068; Exhibit 124: UA0003071.

<sup>31</sup> The interest rate on the deposit was stipulated in the agreement as 0.75 of the LIBOR 2 month USD rate at the date of the agreement.

On December 25, 2009, “secret” Cabinet of Ministers Order No. 2290-ДКК instructed the Treasury to extend the deposit agreement until May 5, 2010. Interest received in accordance with the deposit agreements and relevant extensions was deposited in Account No. 2513101284489 in the following amounts:

- December 7, 2009: €28,728.49
- December 30, 2009: €10,689.66
- May 5, 2010: €59,127.21<sup>32</sup>

The €90 million was used to pay credit facilities required by Naftogaz. Shortly before the instruction of the Cabinet of Ministers of Ukraine dated December 8, 2009, which resulted in the first extension of the deposit agreement, Naftogaz wrote to Prime Minister Tymoshenko, informing her of a €90 million credit facility due which they were unable to repay.<sup>33</sup> This was the exact amount the Cabinet of Ministers ordered withdrawn from the Kyoto Accounts in October.

Naftogaz obtained the credit facility from Ukreximbank, in order to pay Gazprom for natural gas imports which took place in September 2009. The facility was due for repayment on December 6, 2009 and, as a result of insufficient working capital, Naftogaz requested that the Cabinet of Ministers order the Treasury and Ukreximbank to extend the credit facility.

The €90 million was returned from Account No. 2513004004489 to the respective Kyoto Accounts (No. 2513004004489 and No. 2513009034489) on May 5, 2010.<sup>34</sup> As

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<sup>32</sup> Exhibit 125: UA0003462.

<sup>33</sup> Exhibit 126: UA0003429.

<sup>34</sup> Exhibit 127: UA0003053; Exhibit 128: UA0003054.

with the other withdrawals, removing the remaining €90 million from the Kyoto Accounts and using the Kyoto Funds as collateral for a line of credit violated the international contracts and the Budget Code of Ukraine.

## **V. Conclusions and Recommendations**

The Cabinet of Ministers and the former Prime Minister utilized the Kyoto Funds without any regard to international contracts, the purpose of the Kyoto Protocol or the Budget Code of Ukraine. The repeated movement of funds in and out of the Kyoto Accounts was a violation of international contracts signed by NEIA as well as the Budget Code of Ukraine.<sup>35</sup>

Moreover, the former Prime Minister's manipulation of the Kyoto Accounts prohibited NEIA from undertaking important environmental projects that would have created new jobs for the country's citizens. It also prohibited NEIA from filing end of year reports, as required under the international agreements, which caused considerable embarrassment to the country.<sup>36</sup> Moreover, sources report that these actions jeopardized Ukraine's ability to sell carbon emission credits in the future—a potential source of significant revenue for years to come.

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<sup>35</sup> It is unlikely that these actions violated the Kyoto Protocol itself, because the enforcement provisions of the contract pertain solely to overall greenhouse emissions, not carbon emission credits or Greening Activities.

<sup>36</sup> In 2010, NEIA was able to belatedly file a report outlining planned Greening Activities.

# INVESTIGATION RELATING TO PROCUREMENT OF 1000 OPEL COMBO LEISURE ACTIVITY VEHICLES AND MEDICAL EQUIPMENT BY MINISTRY OF HEALTH

## Table of Contents

<b>I.</b>	<b>Introduction .....</b>	<b>73</b>
<b>II.</b>	<b>Executive Summary .....</b>	<b>74</b>
<b>III.</b>	<b>Investigative Findings .....</b>	<b>75</b>
<b>A.</b>	<b>Visit of Austrian Delegation to Ukraine .....</b>	<b>75</b>
<b>B.</b>	<b>Development of Investment Project by Cabinet of Ministers .....</b>	<b>76</b>
1.	<i>Establishment of Working Group .....</i>	<i>76</i>
2.	<i>Issuance of Decree No. 819 .....</i>	<i>77</i>
3.	<i>Supply Offers by Vamed .....</i>	<i>78</i>
4.	<i>Publication of Investment Project by Ministry of Health .....</i>	<i>80</i>
5.	<i>Amendments to Decree No. 819 .....</i>	<i>81</i>
<b>C.</b>	<b>Contract Between Vamed and Ukrmedpostach .....</b>	<b>81</b>
1.	<i>Specification of Equipment to be Supplied .....</i>	<i>82</i>
<b>D.</b>	<b>Financing the Investment Project .....</b>	<b>85</b>
1.	<i>Unicredit Bank Austria AG ("Unicredit") .....</i>	<i>86</i>
2.	<i>Ukreximbank .....</i>	<i>88</i>
<b>E.</b>	<b>Delivery and Current Usage of Vehicles and Equipment .....</b>	<b>89</b>
1.	<i>Opel Combo Vehicles .....</i>	<i>89</i>
2.	<i>Delivery and Current Usage of Medical Equipment .....</i>	<i>91</i>
<b>F.</b>	<b>Cost of Vehicles and Equipment .....</b>	<b>98</b>
1.	<i>Value Added Tax .....</i>	<i>98</i>
2.	<i>Financing Charges .....</i>	<i>99</i>
<b>IV.</b>	<b>Vamed's Corporate Profile .....</b>	<b>100</b>
<b>A.</b>	<b>Corporate Structure .....</b>	<b>100</b>
1.	<i>Vamed AG .....</i>	<i>100</i>
2.	<i>Fresenius Proserve GmbH .....</i>	<i>101</i>
3.	<i>IMIB Immobilien Und Industriebeteiligungen GmbH .....</i>	<i>101</i>
4.	<i>B &amp; C Beteiligungsmanagement GmbH .....</i>	<i>102</i>
<b>V.</b>	<b>Conclusions and Recommendations .....</b>	<b>102</b>



## **I. Introduction**

This report details the Ministry of Health's incurring a €101 million debt to procure medical equipment and 1,000 Opel Combo vehicles, many of which were delivered immediately before the 2010 elections bearing large stickers that indicated, The program of the Government of Tymoshenko.

The investigation conducted with respect to this report is governed by the following sections of the Terms of Reference:

- Public finance, performance of the state budget in respect of revenues and expenditures, formation of public debt and payments under debt obligations, substantiation of granting loans guaranteed by the Government and their repayment in full, utilization of funds for recapitalization of banking system, management of mandatory state social insurance funds. Terms of Reference I.1.
- Public procurement of goods, works and services and compliance with generally prescribed competitive procedures. Terms of Reference I.4.
- Evaluation with respect to compliance with the legislation of Ukraine, international law and practice in all areas set out in these Terms of Reference. Terms of Reference II.
- Conclusion on impact of discovered violations on the state economy. Terms of Reference II.
- Proposals regarding specific measures for improvement of the financial and economic situation in the state. Terms of Reference II.

## **II. Executive Summary**

In July 2009, a delegation of high-level Austrian officials and business leaders visited Kyiv. Two months later, in September 2009, the Ministry of Health, through state-owned enterprise Ukrmedpostach, entered into a contract with an Austrian company called Vamed Engineering GmbH & Co. KG (“Vamed”). The agreement provided that the Ministry of Health would purchase medical equipment worth a total of almost €87.5 million and 1000 Opel Combo leisure activity vehicles worth a total of €12.5 million.

Because there were no funds in the budget for this medical equipment,<sup>1</sup> the Ministry of Health had received approval from the Cabinet of Ministers to borrow up to 500 million to finance these purchases. An Investment Project, entitled “The Procurement of Medical Equipment, Transportation Equipment and Medicines under State Guarantees,” described how the €500 million would be spent. Ultimately, Ukrmedpostach borrowed more than €100 million from two banks to fund the first phase of the project. The smaller loan of €16,267,008.18, plus interest, is due to be repaid on October 5, 2010. The larger loan of €85 million provides for a repayment term ending no later than March 20, 2020. The Ukrainian government will be required to make principal and interest payments on this debt for more than ten years.

The Opel Combo vehicles were distributed to the regions of Ukraine immediately before the 2010 elections with stickers – essentially mobile campaign advertisements – that wrapped along the length of the cars indicating “The program of the Government of Tymoshenko.” At the time the current administration took office, the majority of the

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<sup>1</sup> Interview of confidential source, June 3, 2010.

medical equipment purchased from Vamed remained stored in Ukrmedpostach's warehouse.

In short, public funds and Ukrainian national credit were utilized to purchase Opel Combo leisure utility vehicles – purported to be needed as medical vehicles – that were distributed for apparent partisan political advantage during the lead-up to the 2010 elections. Public resources will continue to be diverted to repay the €101 million debt, plus interest, that was incurred to purchase these materials. Questions have been raised as to whether the purchases from Vamed were necessary and whether the undertaking of debt was prudent. Funds were not available in the 2009 budget to finance these purchases, but funds will have to be appropriated for years to come in order to repay the loans, plus the associated interest and financing charges.

### **III. Investigative Findings**

#### **A. Visit of Austrian Delegation to Ukraine**

According to an official within the Ministry of Health, the agreement with Vamed was first discussed during an official visit by Austrian President Heinz Fischer to Kyiv from July 6 to 8, 2009.<sup>2</sup> The Austrian President was accompanied by a group that included Foreign Minister Michael Spindelegger, Economics Minister Reinhold Mitterlehner, Christoph Leitl, the president of the Austrian Chamber of Commerce, and a business delegation consisting of representatives of 47 companies.

President Fischer's visit received broad coverage in the Ukrainian media. Press reports indicate that Fischer met with President Yushchenko, Prime Minister Tymoshenko

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<sup>2</sup> Interview of confidential source, July 6, 2010.

and Parliamentary Chairman Volodymyr Lytvyn. He attended the opening of the Austrian-Ukrainian Economic Forum in Kyiv together with Ukrainian Economics Minister Bohdan Danylyshyn and Serhii Skrypchenko. Bilateral meetings took place on a ministerial level but these were not reported to have included any health-related matters. The meetings included Foreign Minister Yuri Kostenko, Energy Minister Yuri Prodan and Minister for Family, Youth and Sport Yuri Pavlenko.

Another participant in the delegation was Rudolf Scholten, a member of the board of directors of the Österreichische Kontrollbank (“OeKB”). The OeKB has a virtual monopoly on servicing the Austrian state’s finances and loan activities, yet is owned by the country’s private banks. Scholten is also a political veteran and has held several ministerial appointments. As is outlined below, OeKB was involved in the financing of the Vamed deal as an insurer of the loan to the Ukrainian Government. OeKB was also initially selected to loan 85 million to the Government, but Unicredit Bank Austria AG was later substituted.

## **B. Development of Investment Project by Cabinet of Ministers**

### **1. *Establishment of Working Group***

Immediately following the Austrian delegation’s visit to Kyiv, the Cabinet of Ministers began to formulate an “Investment Project” involving Vamed. Pursuant to the Instruction of the Cabinet of Ministers No. 898-r issued on July 8, 2009, a working group to review the Investment Project was established and Deputy Health Minister Valeriy Bidnyy was appointed the Chairman of the working group.<sup>3</sup> Among other tasks, Bidnyy

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<sup>3</sup> Interview of V. Bidnyy, July 6, 2010.

discussed the Investment Project with then Prime Minister Yulia Tymoshenko.<sup>4</sup> Officials ultimately decided to obtain external financing rather than fund the project through the state budget.<sup>5</sup>

## *2. Issuance of Decree No. 819*

On August 5, 2009 the Cabinet of Ministers issued and former Prime Minister Tymoshenko signed Decree No. 819, which concerned the Ministry of Health and Ukrmedpostach securing credit and implementing an investment project aimed at procuring medical equipment and vehicles.<sup>6</sup> First, Decree No. 819 named Vamed as the supplier of unspecified medical products, equipment and vehicles. According to a source, it was unusual for a Cabinet of Ministers decree to specify a supplier and for procurement to take place without a tender.<sup>7</sup> A separate source indicated that the Investment Project was the first of its kind for the Ministry of Health.<sup>8</sup> Because the project required external financing rather than expenditure of state budgetary funds, the usual tender procedures were not followed.

Second, Decree No. 819 ordered the Ministry of Health “to contract credit” of “no more than 500 million Euros” through a loan from Austrian Bank OeKB to Ukrmedpostach. (The lender was subsequently changed to Unicredit Bank Austria AG, as discussed in further detail below.) The loan was to be used to implement the government secured investment project aimed at providing medical institutions with

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<sup>4</sup> Interview of V. Bidnyy, July 6, 2010.

<sup>5</sup> Interviews of confidential sources, June 22 and 23, 2010.

<sup>6</sup> Exhibit 129: UA0000127-128.

<sup>7</sup> Interview of confidential source, June 22, 2010.

<sup>8</sup> Interview of confidential source, June 22, 2010.

equipment, vehicles, medicines and other supplies. Finally, the decree also ordered Ukrmedpostach to work with Vamed to execute the investment project.

### 3. *Supply Offers by Vamed*

On August 12, 2009, Vamed wrote directly to Deputy Health Minister V.G. Bidnyy in his capacity as head of the Working Group and asked what equipment Vamed could supply.<sup>9</sup> The letter requested the Ministry to provide Vamed with a list of equipment required in order to fulfill the Investment Project. On August 13, the Ministry replied to the letter and specified the quantity of equipment and vehicles required.<sup>10</sup> The letter stated that it was drafted in accordance with Decree No. 819 of August 5, 2009 regarding the purchase by Ukrmedpostach of equipment through credit, and in accordance with the fulfillment of clause 2 of the Cabinet of Ministers Resolution No. 898-R dated 8 July 2009 regarding the creation of a working group on the provision of medical services to rural population.

The letter attached a list estimating the Ministry of Health's requirements for medical equipment and vehicles. For instance, the list includes the need to procure 11,145 scooters and 2,889 specialized automobiles. These automobiles are not characterized further. According to sources within the Ministry of Health, the needs indicated in Bidnyy's letter were based on reports from regional sub-departments of the Ministry to the central headquarters.<sup>11</sup>

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<sup>9</sup> Exhibit 130: UA0005051.

<sup>10</sup> Exhibit 131: UA0000333, UA0000332.

<sup>11</sup> Interviews of confidential sources, June 22, 2010 and July 6, 2010.

On August 19, Vamed replied to Deputy Minister Bidnyy's August 13 letter and set forth proposed terms of an offer.<sup>12</sup> An appendix to the letter stated the quantity and price of the vehicles and equipment that Vamed proposed to supply. The list included 2,889 adapted Opel Combo Arizonas at a price of €16,039 per vehicle. The documentary evidence uncovered indicates that Opel Combos are mentioned for the first time in Vamed's August 19 letter. However, sources have stated that Vamed and the Ministry of Health communicated sometime between the August 12 and August 19 letters and Opel Combos were discussed.<sup>13</sup> Vamed offered to supply either Opel Combos or BMW X3s, but Opel Combos were selected, apparently given that model's superior fuel economy and durability. A source also speculated that Opel Combos were chosen because Opel produced engines and transmissions in Austria, and Vamed favored procuring Austrian-manufactured goods.

Vamed's August 19 letter also stipulated that the Investment Project would be implemented in phases, with the first phase—worth €100 million—to commence by October 1, 2009. The Government would supply 15 percent of the financing for each stage of the Project. The remaining 85 percent would be supplied through an export credit facility guaranteed by the Government. Payment was to occur according to the following schedule: 15 percent in advance, and 80 percent after delivery, and 5 percent upon execution of the delivery-acceptance protocol.

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<sup>12</sup> Exhibit 132: UA0000082.

<sup>13</sup> Interviews of confidential sources, June 23, 2010 and July 6, 2010.

4. *Publication of Investment Project by Ministry of Health*

On August 21, 2009 the Ministry of Health published a formal Investment Project entitled “The Procurement of Medical Equipment, Transportation Equipment and Medicines under State Guarantee,” which had been approved by the “Interdepartmental Working Group on Investments - Health Committee.”<sup>14</sup> The Investment Project bears the signature of the head of the Working Group and Deputy Health Minister Bidnyy. The Project named Vamed as the supplier of equipment, vehicles, medical products and medications and listed the specific goods required. Vamed’s August 19 letter, which outlined the equipment that Vamed proposed to supply, was included in the Investment Project.

The Project further called for €500 million to be spent in an “economically effective” way. Among other things, the prices paid for the medical equipment were required to be comparable to market prices. The first phase of the Investment Project would cost €100 million and included a number of items of medical equipment, as well as 1,000 Opel Combo vehicles. The vehicles were intended to be used as transportation for doctors based in the Regions of Ukraine, to allow them to travel across the region and carry necessary equipment on their rounds. The vehicles were not meant to transport patients, and, therefore, did not require stretchers.

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<sup>14</sup> Exhibit 133: UA0000035.



5. *Amendments to Decree No. 819*

Cabinet of Ministers Decree No. 819 was amended on September 9 and on October 7, 2009.<sup>15</sup> The September 9 amendment, via Decree No. 933, substituted Unicredit Bank Austria as the lender.<sup>16</sup> OeKB, which was formerly the lender, would instead insure the financing. Decree No. 993 also provided for advance payment to Vamed, not exceeding €15 million plus the sum of commissions under the loan facility provided by Unicredit Bank Austria AG, to be made using the funds provided by the State Export-Import Bank of Ukraine (“Ukreximbank”). On October 9, 2009, after it was determined that Decree No. 819 breached Ukrainian budgetary law, former President Viktor Yushenko suspended the implementation of Decree 819 by issuing Presidential Decree No. 815/2009.<sup>17</sup> However, the contract with Vamed and the financing agreements with banks had already been signed by this date and remained in force.

**C. Contract Between Vamed and Ukrmedpostach**

The Ministry of Health entered into a contract, through state-owned enterprise Ukrmedpostach, with Vamed on September 14, 2009, to purchase fifteen types of medical equipment in varying quantities for a total value of €99.9 million.<sup>18</sup> The contract concerned the first phase of the larger Investment Project. Fifteen percent of the total contract price was to be paid in advance, with the remaining 85 percent payable upon delivery, from the funds provided by a credit agreement with Unicredit Bank AG.

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<sup>15</sup> Exhibit 134: UA0005179.

<sup>16</sup> Exhibit 135: UA0002191.

<sup>17</sup> Exhibit 136: UA0002194.

<sup>18</sup> Exhibit 137: UA0000209, UA0000231, UA0000230.

1. *Specification of Equipment to be Supplied*

The contract provided for the supply by Vamed to Ukrmedpostach of 1,000 Opel Combo vehicles at the price of €12,500 per vehicle, for a total cost of €12.5 million.

There is currently no evidence available to show what price Vamed paid for the vehicles.

The contract also covered fourteen other types of equipment. Several versions of specifications, which vary slightly in quantity of products and total price, were attached to the contract.<sup>19</sup> The latest specifications, dated March 18, 2010, lists a total of

99,546,999.55 worth of goods. The vehicles and equipment to be supplied, as set forth in the March 18 specifications, are summarized as follows:

Item No.	Custom Code	Description	Country of Origin	Manufacturer	Unit price, EUR	Quantity	Price, EUR
1	8705 90 90 90	Auto Opel Combo Automobile specialised adapted	Austria	Vamed Engineering GmbH & CO KG Sterngasse 5, A-1230 Vienna, Austria	12,500.00	1000	12,500,000.00
2	9019 20 00 00	Resutator MR 100 adult	Germany	Drager Medical AG & Co.KG Moislinger Allee 53-55, D-23542 Lubeck, Germany Drager Medical Austria GmbH Perfektstrasse 67, A-1230 Wien, Austria	241.00	1245	300,045.00
3	9027 80 11 90	IME-DC Device for measuring blood sugar level	Germany	IME-DC GmbH Kautendorfer Strasse 24, 95145 Oberkotzau, Germany	49.00	7027	344,323.00

<sup>19</sup> Exhibit 138: UA00000004; UA00000005.

4	9018 11 00 00	UCARD-100 Electrocardiograph	Ukraine	TOV Kompaniya UTAS, Kyiv -57, vul. Zhelyabova, 2-a, Ukraine	1,387.00	1000	1,387,000.00
5	9018 90 85 90	HeartStart MRx Defibrillator	Austria	Philips Medical Systems 3000 Millenium Road, Andover, MA 01810- 1099, USA Philips Medical Systems 2301 Fifth Avenue, Suite 200, Seattle, WA 98121, USA Philips Medizinische Systeme GmbH Triester Strasse 64 A-1100 Vienna, Austria	12,527.18	200	2,505,436.00
6	9402 90 00 00	KG-2 GYN Chair	Austria	Panno-med GmbH Siemensstrasse 15, A-7423 Pinkafeld, Austria	1,237.00	500	618,500.00
7	9019 20 00 00	Neonatal and Infant Ventilator Leoni 2	Austria	Heinen+Loewenstein GmbH Arzbacher Str. 80, D-56130 Bad Ems, Germany Heinen+Loewenstein GmbH Clemens- Holzmeister-Str.4, 1100 Vienna, Austria	29,906.00	90	2,691,540.00
8	9019 20 00 00	Carina System Ventilator	Austria	Drager Medical AG & Co.KG Moislinger Allee 53-55, D- 23542 Lubeck, Germany Drager Medical Austria GmbH Perfektstrasse 67, A-1230 Wien, Austria	21,167.00	1000	21,167,000.00

9	9018 90 60 00	Anaesthesia unit Leon	Austria	Heinen+Loewenstein GmbH Arzbacher Str. 80, D-56130 Bad Ems, Germany Heinen+Loewenstein GmbH Clemens- Holzmeister-Str.4, 1100 Vienna, Austria	24,723.00	825	20,396,475.00
10	9018 12 00 00	Diagnostic Ultrasound System HD7 Lite	Austria	Philips Medical Systems 3000 Millenium Road, Andover, MA 01810- 1099, USA Philips Medical Systems 2301 Fifth Avenue, Suite 200, Seattle, WA 98121, USA Philips Medizinische Systeme GmbH Triester Strasse 64 A-1100 Vienna, Austria	34,500.00	250	8,625,000.00
11	9018 12 00 00	Diagnostic Ultrasound System HD11 XE Standard	Austria	Philips Medical Systems 3000 Millenium Road, Andover, MA 01810- 1099, USA Philips Medical Systems 2301 Fifth Avenue, Suite 200, Seattle, WA 98121, USA Philips Medizinische Systeme GmbH Triester Strasse 64 A-1100 Vienna, Austria	49,940.00	400	19,976,000.00
12	9018 90 85 90	Incubator model VISION 2186-CE	Austria	FANEM LTDA AV.Gal. Ataliba Leonel, 1790 CEP:02033-020-Sao Paulo, Brasil Heinen+Loewenstein GmbH Clemens- Holzmeister-Str.4, 1100 Vienna, Austria	15,409.00	90	1,386,810.00

13	9018 90 85 90	Transport incubator model IT-158-TS	Austria	FANEM LTDA AV.Gal.Ataliba Leonel, 1790 CEP:02033-020-Sao Paulo, Brasil Heinen+Loewenstein GmbH Clemens- Holzmeister-Str.4, 1100 Vienna, Austria	58,512.83	85	4,973,590.55
13a	9018 19 90 00	Patient Monitor UM-300P TU U 33.1-24373734- 008-2004	Ukraine	TOV Kompaniya UTAS, Kyiv -57, vul. Zhelyabova, 2-a, Ukraine	3,790.00	85	322,150.00
13b	9018 90 85 10	Infusion Pump USP-100 TU U 33.1-24373734- 005-2003	Ukraine	TOV Kompaniya UTAS, Kyiv -57, vul. Zhelyabova, 2-a, Ukraine	1,150.00	170	195,500.00
14	9018 90 85 90	RESUSCITAIRE RW-82	Austria	Drager Medical System, Inc. 3135 Quarry Road, Telford, PA 18969 USA Drager Medical Austria GmbH Perfektstrasse 67, A- 1230 Wien, Austria	23,537.00	90	2,118,330.00
15	9018 19 10 00	Sonicaid Fetal Dopplex Model FDI	Ukraine	HUNTLEIGH HEALTHCARE Ltd, DIAGNOSTIC PRODUCTS DIVISION 35 Portmanmoor Road, Cardiff, CF 24 5HN, UK	262.00	150	39,300.00
<b>Total</b>							99,546,999.55

#### **D. Financing the Investment Project**

The structure of the investment project financing was developed and modified during August and September 2009. Cabinet of Ministers Decree No. 819 dated August 5,

2009 provided that a total of €500 million would be invested in the project. The financing would be provided by Austrian bank Österreichische Kontrollbank (“OeKB”), and the Ukrainian Government would guarantee the loan.<sup>20</sup> Unicredit Bank Austria AG (“Unicredit”), the bank that ultimately served as the lender, was not mentioned in this Decree.

Through Decree No. 933, dated September 9, 2009, the Cabinet of Ministers replaced OeKB with Unicredit as the lender. Sources have suggested that Vamed identified Unicredit for this role. OeKB remained involved as the insurer of the financing. Decree No. 933 also added a provision for an advance payment to Vamed, which should not have exceeded €15 million plus the sum of commissions under the loan provided by Unicredit, which funds should have been provided by Ukreximbank in the form of a loan to Ukrmedpostach. Finally, the decree specified that additional costs—including interest and commissions—incurred during the investment project would be financed by the Ministry of Health through state budgetary funds appropriated to the Ministry.

Financing agreements were signed with Unicredit on October 7, 2009 and with Ukreximbank on October 6, 2009.

1. *Unicredit Bank Austria AG (“Unicredit”)*

The agreement between Ukrmedpostach and Unicredit provides a financing facility of up to €85 million.<sup>21</sup> Funds are to be disbursed directly from Unicredit to Vamed. Initially, funds were disbursed based on Vamed’s shipping documentation, but this procedure was changed in early May 2010, requiring Ukrmedpostach to certify

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<sup>20</sup> See, e.g., Exhibit 139: UA0000151.

<sup>21</sup> Exhibit 140: UA0000159, UA0000197, UA0000203, UA0000206.

acceptance of the goods before payment is made. Between December 2009 and July 14, 2010, Unicredit disbursed a total of €38,317,768.13 to Vamed. The total value of goods that Ukrmedpostach had received from Vamed as of July 14, 2010 was approximately €85,810,737.54.

a. Charges Relating to the Loan

The Unicredit financing agreement imposed a 5.5 percent annual interest rate. Additional fees were required to be paid to Unicredit for managing the financing, to OeKB for serving as underwriter, and to Ukreximbank for facilitating Ukrmedpostach's banking in connection with the Unicredit loan.

As of July 14, 2010, these financing charges totaled €44,189,354.69:

Expense	€
Interest	27,235,977.70
Management fee to Unicredit	465,302.12
OeKb fee	15,250,075.90
Fee to Ukreximbank	1,237,998.97
Total	44,189,354.69

b. Repayment Terms

Repayment of the principal loan amount begins no later than on March 20, 2011 and continues for ten years.<sup>22</sup> Payments are required twice a year—on March 20 and September 20—in equal installments of €4.25 million. However, if all goods were received before September 2010, then repayment was scheduled to begin on September 20, 2010. Repayment of interest and commissions on the loan began in March 2010 and also occur on a semi-annual basis.

As of July 14, 2010, Unicredit had sent invoices to Ukrmedpostach for a total of 827,149.01. This sum can be broken down into the following components: interest payments (€201,033.09), management fee (€242,604.17), OeKB's fees (€331,523.39), and travel and legal expenses (€51,988.36). Documentation indicates that this payment has been made by Ukreximbank on behalf of Ukrmedpostach.

2. *Ukreximbank*

Ukrmedpostach and Ukreximbank signed a loan agreement on October 6, 2009.<sup>23</sup> Sources have indicated that it is a typical practice for a domestic bank to play a role in the financing arrangements for transactions in emerging markets.<sup>24</sup> The credit agreement provided for a €17 million loan, but this amount was decreased on October 8 to 16,267,008.18.<sup>25</sup> This amount covered the €15 million advance payment to Vamed, plus advance interest and commission payments due to Unicredit and charges due to OeKB. The entire sum has been disbursed. Ukreximbank paid €1,267,008.18 to Unicredit

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<sup>22</sup> Exhibit 141: UA0002222.

<sup>23</sup> Exhibit 142: UA0000133-UA0000148.

<sup>24</sup> Interviews of confidential sources, July 6 and 8, 2010.

<sup>25</sup> Exhibit 143: UA0000149-UA0000150.



directly on October 8, 2009, and transferred 15 million to Vamed's account at Unicredit on October 9, 2009.

The terms of the loan agreement provide for 11.23 percent interest, and a 2 percent annual facilitation commission. A schedule prepared by Ukreximbank calculates that a total of €1,621,629.76 will be payable in interest and commission.

The principal loan amount was to be repaid in five installments beginning on June 1, 2010. Repayment of the interest is to occur in thirteen installments beginning on April 25, 2010 and ending on October 5, 2010. Commissions on the loan are to be repaid monthly.

**E. Delivery and Current Usage of Vehicles and Equipment**

**1. Opel Combo Vehicles**

The Opel Combo vehicles were imported into Ukraine between December 30, 2009 and February 4, 2010. The total customs value of the cars was UAH142 million.

**a. Yulia Tymoshenko Stickers Affixed to Vehicles**

During the months leading up to the 2010 elections, the Opel Combo leisure activity vehicles were distributed to the regions after stickers were applied identifying the cars as originating from the Yulia Tymoshenko Government. The stickers, which wrapped along the length of the Opel Combos, stated, "A Program of the Government of Yulia Tymoshenko."<sup>26</sup> An official of the Ministry of Health stated that the stickers were not paid for by the Ministry and warned other employees that the stickers should "have

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<sup>26</sup> Exhibit 144: UA0005038; UA0005039.

nothing to do with” the Ministry.<sup>27</sup> One reasonable interpretation is that the vehicles were thus able to serve, essentially, as mobile campaign advertisements.

The local police station in one region confirmed that cars were delivered to that region with Yulia Tymoshenko stickers. The regional traffic police headquarters registered the vehicles, photographed them upon delivery, and stored the images electronically. The police provided photographs of four vehicles, two of which were marked with Yulia Tymoshenko stickers.<sup>28</sup>

Site visits also verified that many Opel Combo vehicles were delivered with the Yulia Tymoshenko stickers affixed. In two villages that were visited in one region, witnesses attested through signed declarations to the presence of the stickers.<sup>29</sup> Furthermore, one witness who drove to Kyiv in December 2009 to pick up two vehicles for her Region observed large numbers of Opel Combo vehicles in a garage awaiting distribution, all displaying Yulia Tymoshenko stickers.

The stickers were removed after a circular was received on April 13, 2010 from the Health Defense Department of the Kyiv Oblast administration, which requested recipients to “urgently remove any signs (stickers, drawings, etc.) which are not foreseen by the legal framework” from ambulances and medical vehicles.<sup>30</sup>

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<sup>27</sup> Interview of confidential source, July 6, 2010.

<sup>28</sup> Exhibit 145: UA0005970.

<sup>29</sup> Exhibit 146: UA0005974.

<sup>30</sup> Exhibit 147: UA0005969.

The Opel Combo vehicles have limited medical utility. They are not ambulances and cannot transport a patient lying down on a stretcher. While some vehicles were located at hospitals and used to transport doctors, others were stored at town halls.<sup>31</sup>

## *2. Delivery and Current Usage of Medical Equipment*

The medical equipment provided under the contract is also intended to be distributed to the regions, according to guidelines drafted by the Ministry of Health. However, data provided by Ukrmedpostach shows that approximately 77 percent of the medical equipment delivered by Vamed remains stored at Ukrmedpostach's warehouse in Kyiv. Ukrmedpostach has received approximately €73,310,737.54 worth of equipment, or 84 percent of the total, as of July 13, 2010. The value of medical equipment delivered to the regions is approximately €16,769,922.66. Photographs illustrate the quantity of medical equipment remaining in storage.<sup>32</sup>

Table 1 below shows the medical equipment and cars received from Vamed and indicates the proportion of equipment actually distributed by Ukrmedpostach. Table 2 shows the monetary value of medical equipment distributed to the regions.

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<sup>31</sup> Site visits and interviews with confidential sources, July 7, 2010.

<sup>32</sup> Exhibit 148: UA0005853.

**Table 1: Proportion of equipment distributed to the regions**

Equipment	Manufacturer	Jurisdiction	Quantity required according to contract	Quantity delivered according to Ukrmedp ostach as of 13 July 2010	% delivered	Quantity distributed to regions according to Ukrmedp ostach	% Distributed to regions as of 13 July 2010
Neonatal and Infant Ventilator Leoni 2	Heinen+Lowenstein GmbH	Austria/Germany	90	90	100.00	0	0.00
Incubator model VISION 2186-CE	FANEM LTDA; Heinen+Lowenstein GmbH	Brasil/Australia	90	90	100.00	0	0.00
Transport incubator model IT-158-TS	FANEM LTDA; Heinen+Lowenstein GmbH	Brasil/Australia	85	38	44.71	0	0.00
Patient monitor UM-300P TU U 33.1-24373734-008-2004	TOV Yutas	Ukraine	85	85	100.00	0	0.00
Infusion pump USP-100 TU U 33.1-24373734-	TOV Yutas	Ukraine	170	170	100.00	0	0.00



005-2003								
Sonicaid Fetal Dopplex Model FD1	Huntleigh Healthcare Ltd, Diagnostic Products Division	UK	150	150	100.0 0	4	2.67	
Anesthesia unit Leon	Heinen+Lowenstein GmbH	Austria/Germany	825	432	52.36	12	2.78	
Carina System (Artificial lung respirator)	Drager Medical AG & Co.KG and Drager Medical Austria GmbH	Austria/Germany	1000	940	94.00	36	3.83	
Resutator MR 100 (sic - probably resuscitator)	Drager Medical AG & Co.KG and Drager Medical Austria GmbH	Germany/Austria	1245	1245	100.0 0	55	4.42	
KG-2 (Gynecological chair)	Panno-med GmbH	Austria	500	500	100.0 0	29	5.80	
RESUSCITAIRE RW-82 (reanimation table)	Drager Medical System Inc; Drager Medical Austria GmbH	USA/Austria	90	90	100.0 0	6	6.67	

Diagnostic Ultrasound System HD11 XE Standard	Philips Ultrasound Inc; Philips and Neusoft Medical Systems Co., Ltd; Philips Medizinisch e Systeme GmbH	USA/China/ Austria	400	400	100.0 0	174	43.50
Diagnostic Ultrasound System HD7 Lite	Philips Ultrasound Inc; Philips and Neusoft Medical Systems Co., Ltd; Philips Medizinisch e Systeme GmbH	USA/China/ Austria	250	250	100.0 0	118	47.20
IME-DC (equipment for measuring blood's glucose levels)	IME-DC GmbH	Germany	7027	7027	100.0 0	3737	53.18
UCARD-100 (3 channel electrocardi ograph)	TOV Yutas	Ukraine	1000	1000	100.0 0	620	62.00
HeartStart MRx (Defibulator)	Philips Medical Systems and Philips Medizinisch	USA/Austria	200	200	100.0 0	137	68.50



e Systeme GmbH							
Opel Combo Cars	Vamed Engineering GmbH & Co KG	Austria	1000	1000	100.00	1000	100.00

**Table 2: Value of goods received and distributed**

Equipment	Quantity delivered according to Ukrmedpostach as of 13 July 2010	Price per unit €	Value of goods delivered to Ukrmedpostach warehouse in €	% Distributed to regions as of 13 July 2010 (from table above)	Value of goods distributed to regions in €
Neonatal and Infant Ventilator Leoni 2	90	29,906.00	2,691,540.00	0.00	-
Incubator model VISION 2186-CE	90	15,409.00	1,386,810.00	0.00	-
Transport incubator model IT-158-TS	38	58,512.83	2,223,487.54	0.00	-
Patient monitor UM-300P TU U 33.1-24373734-008-2004	85	3,790.00	322,150.00	0.00	-

Infusion pump USP-100 TU U 33.1-24373734- 005-2003	170	1,150.00	195,500.00	0.00	-
Sonicaid Fetal Dopplex Model FD1	150	262.00	39,300.00	2.67	1,048.00
Anesthesia unit Leon	432	24,723.0 0	10,680,336.00	2.78	296,676.00
Carina System (Artificial lung respirator)	940	21,167.0 0	19,896,980.00	3.83	762,012.00
Resutator MR 100 (sic - probably resuscitator)	1245	241.00	300,045.00	4.42	13,255.00
KG-2 (Gynecological chair)	500	1,237.00	618,500.00	5.80	35,873.00
RESUSCITAIRE RW- 82 (reanimation table)	90	23,537.0 0	2,118,330.00	6.67	141,222.00
Diagnostic Ultrasound System HD11 XE Standard	400	49,940.0 0	19,976,000.00	43.50	8,689,560.00
Diagnostic Ultrasound System HD7 Lite	250	34,500.0 0	8,625,000.00	47.20	4,071,000.00
IME-DC (equipment for measuring blood's glucose levels)	7027	49.00	344,323.00	53.18	183,113.00



UCARD-100 (3 channel electrocardiograph)	1000	1,387.00	1,387,000.00	62.00	859,940.00
HeartStart MRx (Defibrillator)	200	12,527.18	2,505,436.00	68.50	1,716,223.66
Opel Combo Cars	1000	12,500.00	12,500,000.00	100.00	12,500,000.00
<b>Total</b>			<b>85,810,737.54</b>		<b>29,269,922.66</b>
<b>Total - without cars</b>			<b>73,310,737.54</b>		<b>16,769,922.66</b>

On May 14, 2010, Minister of Health Bidnyy issued an order aimed at speeding up the distribution of medical equipment purchases by Ukrmedpostach. The contract provides that Vamed is to train local medical personnel in how to operate the equipment. This training has apparently begun to occur. In addition, on June 9, 2010, the media reported that Ukrainian Prime Minister Mykola Azarov and Austrian Ambassador Wuketich held a meeting at which Vamed representatives were present. According to the media, Prime Minister Azarov assured the Austrian delegation that the Government intends to comply with commitments entered into by the previous governments, so long as they do not contradict Ukrainian legislation. One of the topics discussed was health

care, and Prime Minister Azarov stressed his intention to use the know-how of foreign experts to improve the Ukrainian health care sector.

#### **F. Cost of Vehicles and Equipment**

On November 27, 2009, Deputy Health Minister Bidnyy wrote to the First Deputy Prime Minister O.V. Turchinov, requesting that the Ministry of Economics conduct a review of the prices for goods in the Vamed contract from manufacturers. The Ministry of Economics' response on January 25, 2010 indicated that, generally, prices in the contract were not higher than those which could be obtained from manufacturers. For instance, Opel Combos, purchased from Vamed at €12,500, would cost between €16,000 and €18,000 in the market. However, this is the price of one car and does not appear to account for a potential discount received by purchasing a large quantity of vehicles. Details of price comparisons for four items were not provided. Additional potential markups to prices were considered during the course of the investigation.

##### *1. Value Added Tax*

The Investment Project and the contract between Vamed and Ukrmedpostach<sup>33</sup> contemplated that the Opel Combo vehicles would be exempt from VAT and customs duties because they would be classified as medical vehicles. The Opel Combos did not qualify under the existing VAT medical exception because their purpose was not

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<sup>33</sup> See Section 2.5 of the contract:

medical equipment, supplied under the current contract, is included in the State register of medical equipment and medical products or will be included into the said register before the [beginning] of shipments; the certificate of the state registration of the Equipment in Ukraine in the required format has been obtained, and this is why operations connected to selling such equipment are not subject to VAT under part 5.1.7 of the Law of Ukraine 'On Value-Added Tax,' and not subject to customs duties.

primarily or exclusively medical. A letter from the Ukrainian Medical Certification Center of the Ministry of Health explained that the Opel Combos did not meet certain national standards for “Emergency First Aid Vehicles and their Equipment” or “Medical Products.” Among other things, the Opel Combos could not transport a patient on a stretcher and did not have any special medical equipment installed.<sup>34</sup>

However, sources have said that all of the government individuals involved in the transaction knew that the vehicles were, at the time, subject to VAT. Officials intended to make the Opel Combos VAT-exempt, but such efforts were unsuccessful.<sup>35</sup>

Ukrmedpostach was, therefore, liable for VAT on the vehicles but lacked the funds to pay the total sum of UAH36,965,542.22. On December 23, 2009, the Cabinet of Ministers issued Decree No. 1616-r approving postponement of the VAT payment, at the Ministry of Health’s request.

## *2. Financing Charges*

The end result, however, is that the Government paid an inflated price for the medical equipment and vehicles because of the financing charges incurred—a total of 45,810,984.45. For example, these charges would add approximately 5,753.86 per car, considering that approximately 12.56 percent of the overall contract price related to the vehicles. The total additional liability in connection with the cars, then, is €5,753,859.65 or UAH 62,423,985.83 using historical exchange rates.

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<sup>34</sup> Exhibit 149: UA0005047.

<sup>35</sup> Interviews of confidential sources, June 23 and July 6, 2010.

This calculation is summarized in the following table:

Unicredit Financing charges €	Ukreximbank charges €	Total Charges €	Cars as % of overall purchase price	Charges relating to cars €	Charge per car €
44,189,354.69	1,621,629.76	45,810,984.45	12.56%	5,753,859.65	5,753.86

Based on these calculations, the financing charges would lead to a final price per car of €18,253.86, compared to a contract price of €12,500.

#### **IV. Vamed's Corporate Profile**

##### **A. Corporate Structure**

Vamed Engineering GmbH & Co. KG was incorporated in Austria on 25 September 1997. It is registered at Sterngasse 5, 1230 Vienna. Corporate records list its nature of business as technical planning. Vamed Engineering GmbH & Co. KG's directors are listed in corporate filings as Vamed Engineering GmbH, Vamed AG and Dr. Johann Strahlhofer of Josef Postl Gasse 25, 2332 Hennersdorf.

##### **1. *Vamed AG***

Vamed AG, an Austrian entity is the general partner of Vamed Engineering GmbH & Co. KG, and the limited partner is Vamed Engineering GmbH, a wholly owned subsidiary of Vamed AG. Vamed AG has been identified in corporate databases as 77% owned by German entity Fresenius Proserve GmbH, with the remainder held by two Austrian entities, Imib Immobilien Und Industriebeteiligungen GmbH with 13% and B & C Beteiligungsmanagement GmbH with 10%.

## 2. *Fresenius Proserve GmbH*

Fresenius Proserve GmbH, which owns 77% of Vamed AG, is wholly owned by German entity Fresenius SE, which is listed on the German DAX and the Prime Pharma & Healthcare index as well as in the Dow Jones STOXX 600. Fresenius SE is a global health care company offering services split into four independent business segments: Fresenius Medical Care, Fresenius Kabi, Fresenius Helios and Fresenius Vamed.<sup>36</sup> Media research indicates that Fresenius Vamed operates under the name Vamed AG.

Fresenius Vamed is reported to specialize in international projects for hospitals and health care facilities and is headquartered in Vienna. Fresenius SE's annual report for 2009 states that Fresenius Vamed won a large-scale contract for the supply of medical equipment to improve infrastructure in rural areas in Ukraine and that the contract was to be processed in 2010. Media reports also document Vamed's role in providing medical equipment to the Ukrainian Government and its involvement in the health care sector in other countries. Vamed has been discussed in the media as a provider of medical equipment to the Ukrainian Government.<sup>37</sup>

## 3. *IMIB Immobilien Und Industriebeteiligungen GmbH*

Imib Immobilien Und Industriebeteiligungen GmbH, which owns 13% of Vamed AG, is listed in corporate filings as wholly owned by Österreichische Industrieholding AG, also an Austrian entity, which in turn is wholly owned by the Austrian state.

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<sup>36</sup> Exhibit 150:UA0005949.

<sup>37</sup> See, e.g., Exhibit 151: UA0005950; Exhibit 152: UA0005951; Exhibit 153: UA0005965; Exhibit 154: UA0005967.

#### 4. *B & C Beteiligungsmanagement GmbH*

B & C Beteiligungsmanagement GmbH owns 10% of Vamed AG and is owned by B & C Holding GmbH (99%) and LBC Unternehmensbeteiligungsges.M.B.H. (1%), both Austrian entities. B & C Holding GmbH is in turn wholly owned by B & C Beteiligungsverwaltungs GmbH, an Austrian entity, which is wholly owned by B & C Privatstiftung, an Austrian trust.

LBC Unternehmensbeteiligungsges.M.B.H. is wholly owned by Immobilien Holding GMBH, an Austrian entity which in turn is owned by Immobilien Privatstiftung, an Austrian trust. Private Austrian trusts do not have to file shareholder information, and therefore it has not been possible to identify the ultimate beneficial shareholders of B & C Privatstiftung or Immobilien Privatstiftung

#### V. **Conclusions and Recommendations**

In sum, the Ministry of Health incurred €100 million in debt that must be repaid by subsequent administrations over the next ten years, after the useful life of the vehicles and medical equipment has expired. Much of the medical equipment remains unused, and the leisure activity vehicles, which have limited medical utility, were distributed immediately before the 2010 elections with stickers indicating “The program of the Government of Yulia Tymoshenko.”

More thorough consideration of documented needs for procurement of medical equipment for Ukraine and its Regions seems to be necessary. This is especially true when, as in this case, funds are not available in the budget and debt must be incurred and subsequently repaid over a long period of time. Greater transparency is also warranted,

as it remains unclear why the contract with Vamed and the Investment Project were facilitated, and whether the transaction involved any *quid pro quo* or other personal benefits to those negotiating and agreeing to the transaction. Finally, greater regulation of the distribution and use of items procured by the Government would prevent these items from being used to promote individual politicians or political parties.

# INVESTIGATION RELATING TO PURCHASE OF PHARMACEUTICAL PRODUCTS AND MEDICAL EQUIPMENT BY THE MINISTRY OF HEALTH IN 2008 AND 2009

## Table of Contents

<b>I.</b>	<b>Introduction .....</b>	<b>106</b>
<b>II.</b>	<b>Executive Summary .....</b>	<b>107</b>
<b>A.</b>	<b>Overview of the Schemes.....</b>	<b>108</b>
<b>B.</b>	<b>The Tender Process .....</b>	<b>109</b>
<b>C.</b>	<b>Lack of Cooperation from the Ministry of Health.....</b>	<b>109</b>
<b>III.</b>	<b>Background on the Ministry of Health's Procurement Process.....</b>	<b>110</b>
<b>IV.</b>	<b>Background on Mark-Ups Permitted by Ukrainian Law.....</b>	<b>113</b>
<b>V.</b>	<b>Investigative Findings .....</b>	<b>114</b>
<b>A.</b>	<b>Interfarm .....</b>	<b>114</b>
1.	<i>Corporate Profile .....</i>	<i>114</i>
2.	<i>Government Contracts Reviewed.....</i>	<i>116</i>
3.	<i>Interfarm Entered Into Sham Contracts with Foreign Shell Company Olden Group LLC To Conceal the True Mark-Ups .....</i>	<i>118</i>
4.	<i>Olden Group LLC .....</i>	<i>122</i>
<b>B.</b>	<b>Imbioimpex.....</b>	<b>126</b>
1.	<i>Corporate Profile.....</i>	<i>126</i>
2.	<i>Five Contracts Were Analyzed.....</i>	<i>126</i>
3.	<i>There Were Significant Irregularities in the Tender Process .....</i>	<i>128</i>
4.	<i>The Government Contracts Obtained by Imbioimpex Totaled More Than UAH 10 Million.....</i>	<i>129</i>
5.	<i>Imbioimpex Entered Into Sham Contracts with Foreign Shell Companies To Disguise Mark-Ups .....</i>	<i>129</i>
6.	<i>Pricing Data Strongly Suggests that Actual Mark-Ups Exceeded 10% Limit .....</i>	<i>131</i>
<b>C.</b>	<b>United Medical Service.....</b>	<b>134</b>
1.	<i>Corporate Profile .....</i>	<i>134</i>
2.	<i>Government Contracts .....</i>	<i>134</i>
3.	<i>Contracts with Foreign Shell Companies .....</i>	<i>135</i>
4.	<i>Jade Commercial Limited .....</i>	<i>137</i>
5.	<i>Pricing Data.....</i>	<i>139</i>
<b>D.</b>	<b>Tri-Tsentrалny Aptechny Sklad.....</b>	<b>142</b>
1.	<i>Summary of Key Findings .....</i>	<i>142</i>
2.	<i>Corporate Profile .....</i>	<i>143</i>



3.	<i>Bidding Process</i> .....	144
4.	<i>Government Contracts</i> .....	147
5.	<i>Contracts with Foreign Shell Company</i> .....	149
<b>E.</b>	<b>Sumskaya</b> .....	154
1.	<i>Bidding Process</i> .....	154
2.	<i>Government Contract</i> .....	155
3.	<i>Contracts with Ukrainian Intermediaries</i> .....	156
<b>VI.</b>	<b>Conclusions and Recommendations</b> .....	159

## **I. Introduction**

This report discusses a number of transactions between the Ministry of Health and five separate Ukrainian intermediary companies from which the Ministry procured vaccines, pharmaceuticals, and medical equipment. The Ukrainian intermediaries involved offshore intermediaries in the transactions as a means to conceal their true profit and the amount that manufacturers' prices were marked up when the Ukrainian companies sold to the government.

The investigation conducted with respect to this report is governed by the following sections of the Terms of Reference:

- Performance of the state budget in respect of revenues and expenditures. Terms of Reference I.1.
- Public procurement of goods, works and services and compliance with generally prescribed competitive procedures. Terms of Reference I.4.
- Evaluation with respect to compliance with the legislation of Ukraine, international law and practice in all areas set out in these Terms of Reference. Terms of Reference II.
- Conclusion on impact of discovered violations on the state economy. Terms of Reference II.
- Proposals regarding specific measures for improvement of the financial and economic situation in the state. Terms of Reference II.

## **II. Executive Summary**

During 2008 and 2009, the Ministry of Health purchased vaccines, pharmaceuticals, and medical equipment from five Ukrainian companies, four of which were associated with a layer of foreign shell companies. The Ministry, through state-owned enterprises Ukravaktsina, Ukrmedpostach, and Politekhmed, paid the five Ukrainian contractors – Interfarm, Imbioimpex, United Medical Service, Tri-Centralny Aptechny Sklad, and Sumskaya – more than UAH 250 million for vaccines and pharmaceuticals and UAH 100 million for medical supplies.

The Ukrainian contractors made it appear that they had purchased the goods through foreign intermediaries – shell companies with secret or offshore owners. Significant amounts of money paid by the Ministry of Health to the Ukrainian companies were transferred to foreign intermediaries' bank accounts in Latvia and Lithuania. Although the foreign intermediaries purported to buy the vaccines from the manufacturers and sell them to the Ukrainian contractors, in fact there is no evidence to suggest that the foreign intermediaries performed any legitimate work relating to the supply of the vaccines. Customs documents show that the vaccines were shipped directly from the manufacturers to Ukraine. Through the use of the foreign shell companies, the Ukrainian contractors were able to circumvent the Ukrainian law that prohibits mark-ups in excess of 10 percent of the customs value on such products and thereby charge the Ministry an inflated price. The foreign shell companies and Ukrainian intermediaries carried out their scheme by entering into sham contracts and submitting fraudulent customs documents to conceal the actual price that the Ukrainian companies paid the

manufacturers for the medical products. The true mark-ups (over the manufacturers' prices) paid by the government to these contractors are therefore generally higher than customs declarations and the sham contracts would indicate. Industry sources indicate that, in many instances, the vaccines and medical supplies could have been procured for one-half the price the Ukrainian contractors charged the government.

**A. Overview of the Schemes**

- Interfarm used a U.S. shell company called Olden Group, LLC to conceal its mark-ups on Sanofi Pasteur-manufactured vaccines. The company is owned by two other shell companies in the offshore jurisdictions of Belize and the island of Niue.
- Imbioimpex claimed to have obtained vaccines through two intermediaries, Virion GmbH, which is incorporated in the Seychelles, and Hostas, which is incorporated in New Zealand.
- United Medical Service concealed manufacturers' prices through the use of a shell company incorporated in the UK called Jade Commercial Ltd. The sham contracts between United Medical and Jade were executed well before United Medical was awarded the government contracts, but were for the same quantity of goods that the Ministry eventually purchased, suggesting corrupt influence over the bidding process.
- Tri-Tsentralny Aptechny Sklad used a UK shell company called Eurostate as an intermediary.

In each case, the foreign intermediary exists only on paper and never took possession of the vaccines. The most reasonable conclusion is that the sham contracts between the Ukrainian companies and the foreign intermediaries served to conceal the manufacturer prices and allow Ukrainian contractors to charge inflated prices to the government. Confidential sources provided pricing analysis relating to certain pharmaceuticals and medical products and confirmed that the government was charged more than a 10 percent mark-up over the manufacturer prices.

#### **B. The Tender Process**

The Investigative Firms' audit also revealed that the tender process utilized by the Ministry of Health is largely dysfunctional. Many of the Ukrainian companies are repeat contractors with the Ministry of Health, and the companies' principals have ties to the Ministry or other government connections. Tender documentation relating to certain of the contracts involving the Ministry of Health and the five companies reveals collusive bidding. For example, in several instances, there are only two companies participating in the tender and the losing company will have the same address as the winning contractor and a telephone number that reaches the offices of the winning contractor. The Ministry of Health expressed no concern with the issue of collusive bidding. Instead, it appears that the Ministry views its role as to do nothing more than to select the lowest bidder.

#### **C. Lack of Cooperation from the Ministry of Health**

Finally, some of the witnesses who cooperated in our investigation were terminated shortly after we interviewed them or as they were gathering documents to provide to investigators. No one within the Ministry of Health was able to provide a

convincing explanation of the decision to terminate these employees. Several Ministry officials provided evasive and incomplete answers when questioned on the subject of firings and the Ministry was consistently slow to provide documents and grant interview requests. In sum, the Ministry's conduct was inconsistent with its pledge to fully cooperate with the investigation.

### **III. Background on the Ministry of Health's Procurement Process**

Both before and after the Ministry of Health of Ukraine (the "MHU") decides to procure particular medical goods, a series of steps are, at least in theory, followed. The first stage of the procurement process involves researching the need for a particular vaccine or piece of equipment. This is the responsibility of the Expert Committee of the Tender Committee. The Expert Committee consists of doctors, scientists, physicians and researchers, who evaluate the quantity of vaccines needed for each region, make recommendations to the tender committee on vaccine purchases, and monitor complaints of adverse reactions.

On an annual basis, each of Ukraine's 27 regions submits a list of the vaccines required. The expert committee evaluates the requests and prepares recommendations for the tender committee. The Expert Committee cannot recommend that the MHU purchase more vaccines than requested by the regions. Their recommendations are compiled in a technical document, which details the approximate quantity required for the year and the approximate price per dose and total cost. A member of the Expert Committee explained that the committee largely uses the price from the previous year as the basis for the

recommended price.<sup>1</sup> The General Director of Ukrmedpostach explained that this annual procurement plan is published on the website of the MHU and is therefore accessible to all of the Ukrainian intermediaries described below.<sup>2</sup>

The expert report is then passed to the Tender Procedures Department, the secretarial department of the Tender Committee, which reviews the report and enters it on the Tender Committee agenda. The Tender Procedures Department compares the prices in the annual technical document to the previous year's prices. If the price is higher than the previous year, the Expert Committee is required to explain the discrepancy. A source explained that approximately three years of previous prices are taken into account when setting the vaccine budgets as prices fluctuate as a result of the manufacturers' price changes and exchange rate fluctuations.<sup>3</sup> However, consulting only prior years' prices allows markups to become entrenched.

The Tender Committee includes approximately nineteen MHU officials. Once a decision regarding the tender request has been made by the Tender Committee, the Tender Procedures Department publishes an announcement in the State Procurement Bulletin for approximately one month. In order to respond to the tender request, an entity must be a resident of Ukraine or otherwise be properly registered to do business in Ukraine.

After the deadline for submitting bids arrives, the bids are opened and the proposals are all publicly announced. Bidders are typically present at the announcement.

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<sup>1</sup> Interview of confidential source, August 6, 2010.

<sup>2</sup> Interview of confidential source, August 25, 2010.

<sup>3</sup> Interview of confidential source, August 6, 2010.

The name of each bidder and the price bid are recorded. After the envelopes have been opened, the tender committee has 30 days to decide which bidder to select. The Tender Committee ensures that all bids are complete, and the expert group then reviews the technical documents submitted by bidders. The Expert Committee prepares a table summarizing the details of each bid, including quantity, manufacturer, and other criteria. The conclusions of the expert group are taken into consideration by the Tender Committee when making a decision. According to a witness interviewed, the price and quality of the products are the main factors in the decision.<sup>4</sup>

The bids are again evaluated by the Tender Committee, and the lowest bid is selected. If the Ministry's budget for the specified vaccine is not sufficient to meet the price of the lowest bidder, then the number of vaccines requested will be reduced. The total price of the purchase and the revised number of units required is then sent to the winning bidder to be accepted. Information regarding the winning bidder and the quantity and price of the vaccines being supplied is recorded in a decree that is then sent to a state enterprise. The state enterprises are then responsible for contacting the Ukrainian intermediary that has won the tender. Ukrvaksina is responsible for vaccine procurement. The other state enterprises relevant to this investigation are Politekhmed and Ukrmedpostach.

The state enterprises have no involvement in the tender process and are instructed by the Ministry to enter into a supply contract and to ensure that the contract is fulfilled in terms of delivery, quality and timing. One source explained that Ukrvaksina's role in

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<sup>4</sup> Interview of confidential source, August 6, 2010.



the vaccine procurement process includes managing the paperwork, receiving and inspecting the goods, verifying the amount and quantity of goods received, reviewing certification from the manufacturer, storing the vaccines and distributing vaccines to the regions.<sup>5</sup> Another witness explained that Politekhmed's task is to prepare the agreement, transport the goods, assemble the equipment and provide support during the guarantee period.<sup>6</sup>

If poor quality goods are delivered, the intermediary is required to replace them and pay a fine. Fines are also imposed if the intermediary defaults on the time schedule. A witness explained that the MHU had no information on the mark up applied by the entities in the procurement process but agreed with the inference that Ukrainian companies are likely hiding their profit margin by using foreign intermediaries.<sup>7</sup> Other witnesses stated that the state enterprises had no information about the foreign intermediaries but suspected that the foreign companies added no value to the process.<sup>8</sup>

#### **IV. Background on Mark-Ups Permitted by Ukrainian Law**

Decree of the Cabinet of Ministers No. 955, dated October 17, 2008,<sup>9</sup> which became effective on November 6, 2008 and was amended by Decree No. 333 on March 25, 2009,<sup>10</sup> governed pricing markups with respect to pharmaceuticals. The Decree provided that, when pharmaceuticals are procured in full or in part with state funds, the supplier's sale mark-up to the government shall not exceed 10 percent of the wholesale

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<sup>5</sup> Interview of confidential source, July 9, 2010.

<sup>6</sup> Interview of confidential source, August 17, 2010.

<sup>7</sup> Interview of confidential source, July 15, 2010.

<sup>8</sup> Interview of confidential source, July 9, 2010.

<sup>9</sup> Exhibit 155: UA0005850.

<sup>10</sup> Exhibit 156: UA0005840.

price. (A 10 percent mark-up was also permitted under Decree No. 1548, issued in December 1996.) The wholesale price is defined in Decree No. 955 as the unit price of the goods imported. The unit price of the imported goods, in turn, is defined as the price listed on the customs declaration. Thus, the supplier cannot add more than a 10 percent markup to the customs value when selling to the government.

In the transactions that were investigated, the price mark-up between the Ukrainian intermediary and the Ministry of Health was within the 10 percent limit. However, as discussed in more detail below, the true markup is hidden and is much higher. The foreign intermediary, which adds no value to the transaction, is present merely to conceal the manufacturer's price, thus enabling the Ukrainian intermediary to list a higher customs value, and obscure the actual profit gained by the Ukrainian companies through markups well above the 10 percent threshold.

## **V. Investigative Findings**

This investigation consisted of five distinct but related investigations into transactions involving the Ministry of Health, state-owned enterprises, and Ukrainian companies Interfarm, Imbioimpex, United Medical Service, Tri-Tsentralny Aptechny Sklad, and Sumskaya.

### **A. Interfarm**

#### **1. *Corporate Profile***

Interfarm is well known on the Ukrainian market for supply and distribution of pharmacological and medical products and is among the top suppliers of medical products under state procurements contracts, winning numerous tenders for medical

supplies year after year. Founded in 1994, Interfarm has been supplying medicines under state contracts since at least the early 2000s.

In 2009, Interfarm, together with Ganza and Tri-TsAS (see below), was one of the top five contractors for state procurement by MHU.<sup>11</sup> The dominance of some companies, including Interfarm, in the state procurement market and the high prices that they have been charging for their products have long been a subject of controversy in Ukraine.<sup>12</sup>

In May 2010, the Ministry of Economics disclosed a publication about contracts to procure vaccines that the MHU concluded between April 13 and 15, 2010. Interfarm was named among the largest recipients of funds from MHU, obtaining UAH 97 million.<sup>13</sup> In November 2009, Interfarm was ranked fifth in terms of the volume of state tenders won, totaling UAH 112.7 million.<sup>14</sup> A report in February 2007 in Apteka, a trade publication of the pharmaceutical industry, stated that five companies shared the vast majority of MHU procurement orders. The list included Interfarm, which it said, was working with Aventis Pasteur (now known as Sanofi Pasteur).<sup>15</sup> In June 2010, Interfarm was included on the “green list” of companies by the Ukrainian customs authorities, which are subject to simplified rules of customs control and process.

The limited liability company OOO Interfarm was incorporated on November 9, 1994 and maintains an office and a website. According to corporate records, Yaroslav Viktorovich Sorokovyi is the head of the company. Vadim Ivanovich Romanyuk and

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<sup>11</sup> Дело (Київ) ; 03.02.2010

<sup>12</sup> Poltbyki, 23.11.2009

<sup>13</sup> StartUA.com ; 18.05.2010

<sup>14</sup> proUA.com, 24 November 2009

<sup>15</sup> Apteka, 12 March 2007

Aleksey Borisovich Zak are equal owners of the company. All three of these individuals signed the contracts in relation to the purchase of vaccines by the MHU in 2008 and 2009. According to corporate records, the company was founded by Romanyuk, Zak, Vladimir Evgenievich Zhukov, and Nikolay Sergeevich Taranenko.

In June 2009, one publication claimed that the MHU allows its suppliers to work with delays, citing examples in which several companies, including Interfarm and Tri-TsAS, supplied vaccines 100-165 days after payment was made. The article questioned why MHU was allowing such interest-free credit and suggested that it was never done without benefit for those who allowed these delays.<sup>16</sup>

## *2. Government Contracts Reviewed*

The investigative team reviewed five government contracts between the MHU, Interfarm and state enterprise Ukrvaksina in relation to the provision of medical vaccines:

- Government Contract 1/1 signed on 19 March 2008 for 641,725 units of TETRAct-HIB at UAH 40.80 per unit. The total value of the contract was UAH 26,182,380.<sup>17</sup>
- Government Contract 1/2 signed on 19 March 2008 for 95,000 units of Trimovax at UAH 41.28 per unit. The total value of the contract was UAH 3,921,600.<sup>18</sup>
- Government Contract 1/7 signed on 20 March 2008 for 450,273 units of Pentaxim at UAH 160 per unit. The total value of the contract was UAH 72,043,680, divided into seven separate batches.<sup>19</sup>

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<sup>16</sup> Exhibit 157: UA0005978.

<sup>17</sup> Exhibit 158: UA0002226-31.

<sup>18</sup> Exhibit 159: UA0002490-95.

- Government Contract 1/8 signed on 20 March 2008 for 342,840 units of Imovax Polio at UAH 38.11 per unit. The total value of the contract was UAH 13,065,632.40.<sup>20</sup>
- Government contract 1/1 signed on 5 February 2009, for 46,642 units of Trimovax at UAH 68.11 per unit. The total value of the contract was UAH 3,176,786.62.<sup>21</sup> The contract was amended on 14 August 2009 to 46,349 units at UAH 68.54 per unit, amounting to a total contract value of UAH 3,176,760.46.

All five contracts stipulate that the vaccines are to be acquired from Sanofi Pasteur in France. The total value of the five contracts amounts to UAH 118,390,052.86. The first four contracts, all signed in 2008, stipulate that Ukrvaksina shall make a 100 percent prepayment of the total price of the goods to Interfarm 90 days before Interfarm actually supplied any vaccines. The fifth contract, signed in 2009, stipulates that the payment of the goods shall be made within seven days from the date of delivery of the goods.

On behalf of the MHU, the first four contracts are signed by First Deputy Minister of Health M.G. Prodanchuk, and the fifth contract is signed by Deputy Minister of Health Z Mytnyk. On behalf of Interfarm, the first four contracts are signed by Commercial Director O.B. Zak, and the fifth contract is signed by Director Ya Sorokovyi.

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<sup>19</sup> Exhibit 160: UA0002273-79.

<sup>20</sup> Exhibit 161: UA0002255-60.

<sup>21</sup> Exhibit 162: UA0002298-304.

3. *Interfarm Entered Into Sham Contracts with Foreign Shell Company Olden Group LLC To Conceal the True Mark-Ups*

Interfarm entered into eight contracts with a shell company called Olden Group LLC that corresponded to and purported to fulfill Interfarm's contracts with the MHU.<sup>22</sup>

The following contracts were reviewed:

Date	Vaccine	Units	Unit Price	Total Price
5/8/08	TETRAct-HIB	321,300	\$8.113	\$2,606,706.90
7/25/08	TETRAct-HIB	217,680	\$8.113	\$1,766,037.84
8/6/08	TETRAct-HIB	103,050	\$8.113	\$836,044.65
5/8/08	Trimovax	95,100	\$8.2084	\$780,618.84
5/8/08	Pentaxim	80,020	\$31.8157	\$2,545,892.31
7/25/08	Pentaxim	370,293	\$31.8157	\$11,781,131.00
5/8/08	Imovax Polio	342,910	\$7.5781	\$2,598,606.27
4/2/09	Trimovax	46,660	€6.15	€286,959.00

The contracts state that Olden Group will supply to Interfarm vaccines manufactured by Sanofi and provided for payment to Olden Group's bank account in Latvia, through correspondent accounts at New York banks. In total, the MHU paid a mark-up amounting to UAH 2,536,817.56 on the five contracts with Interfarm, when compared to Interfarm's corresponding contracts with Olden Group. While this 2.2 percent approximate markup was within permissible boundaries, the actual markups were

<sup>22</sup> Exhibit 163: UA0002232-35; Exhibit 164: UA0002238-41; Exhibit 165: UA0002244-47; Exhibit 166: UA0002261-64; Exhibit 167: UA0002280-83; Exhibit 168: UA0002286-91; Exhibit 169: UA0002265-68; Exhibit 170: UA0002305-08.

almost certainly more significant because Olden Group is a shell company that did not actually perform any work on the contracts. The eight agreements between Interfarm and Olden Group were sham contracts designed to deceive the Ukrainian government. For example, whereas the MHU paid \$8.113 per dose for TETRAct-HIB vaccine, industry sources stated that this vaccine could be purchased for approximately \$2. Likewise, industry sources report that the Trimovax vaccine could be acquired at \$4-5 per dose, but the government paid \$8.2084.

Interfarm used Olden Group to hide the true price that Interfarm paid for the vaccines and thereby increased its profit by charging more than a 10 percent markup. There is no evidence that Olden Group performed any services under the contracts or ever took possession of the vaccines. For example, Olden Group's invoices to Interfarm indicate that Sanofi Pasteur sent the goods directly to Interfarm, through Borispol airport.<sup>23</sup> (Nevertheless, Interfarm stated on customs documentation that Olden Group was the sender of the goods.)<sup>24</sup> The contracts between Interfarm and Olden Group were a sham designed to evade Ukrainian law regarding permissible mark-ups and disguise the inflated prices that Interfarm was charging Ukrvaksina. Despite Olden Group's failure to provide any legitimate value under the contracts, Olden Group managed to obtain more than US\$23 million (or approximately UAH 182 million)<sup>25</sup> from the scheme with

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<sup>23</sup> See, e.g., Exhibit 171: UA0002248; Exhibit 172: UA0002269; Exhibit 173: UA0002270; Exhibit 174: UA0002284; Exhibit 175: UA0002292; Exhibit 176: UA0002294; Exhibit 177: UA0002296.

<sup>24</sup> See, e.g., Exhibit 178: UA0002249; Exhibit 179: UA0002271; Exhibit 180: UA0002272; Exhibit 181: UA0002285; Exhibit 182: UA0002293; Exhibit 183: UA0002295; Exhibit 184: UA0002297.

<sup>25</sup> The total value of the contracts between Interfarm and Ukrvaksina that were reviewed is UAH 118,390,052.86.

Interfarm during a 13-month period.<sup>26</sup> The known transfers of funds from Interfarm to Olden Group's Latvian bank account are summarized in the following table:

Date of Wire	Amount (USD)	Alleged Price Per Dose	Interfarm Bank Account	US Banks Involved	Olden Group Bank Account
6/17/2008	\$2,606,706.90	\$8.113	JSC ProCredit, Ukraine; Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc. #6084480019
6/17/2008	\$2,545,892.31	\$31.8157	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019
6/19/2008	\$2,387,911.12	\$7.5781; \$8.2084	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019
6/19/2008	\$991,313.00	\$7.5781	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019
8/04/2008	\$3,837,418.84	\$31.8157	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019

<sup>26</sup> See Exhibits 171-177 (cited above). See also Exhibit 185: UA0002332; Exhibit 186: UA0002309; Exhibit 187: UA0002236; Exhibit 188: UA0002242.



Date of Wire	Amount (USD)	Alleged Price Per Dose	Interfarm Bank Account	US Banks Involved	Olden Group Bank Account
8/11/2008	\$3,840,192.16	\$31.8157	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019
8/12/2008	\$1,766,037.84	\$8.113	JCS ProCredit Ukraine; Acc #00416150	Deutsche Bank; New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc. #6084480019
9/03/2008	\$836,044.65	\$8.113	JSC ProCredit, Ukraine; Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc. #6084480019
10/14/2008	\$4,462,883.69	\$31.8157	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019
11/6/2008	EUR 68 878,90 (\$87,861.92)	EUR 20,89 (\$26.6473)	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019
8/03/2009	EUR 286 959,00 (\$410,437.46)	EUR 6.15 (\$8.7963)	JSC ProCredit, Ukraine, Acc #00416150	Deutsche Bank, New York, NY; JP Morgan Chase Bank, New York, NY; American Express Bank, New York, NY	Parex Bank, Latvia, Acc #6084480019

Date of Wire	Amount (USD)	Alleged Price Per Dose	Interfarm Bank Account	US Banks Involved	Olden Group Bank Account
<b>TOTAL:</b>	\$23,772,699.89				

#### 4. *Olden Group LLC*

Olden Group LLC was incorporated on March 25, 2003 and is registered in the United States, in the State of Oregon.<sup>27</sup> The members of the company are listed as:

- Worldwide Management Corporation, registered in Belize. The entity was incorporated on January 15, 2002 and is registered at P.O. Box 346 Corozal Town, Belize. P.O. Box 346 is shared by at least five other shell companies, all of whom share the same registered agent, Cititrust International Limited, Belize.<sup>28</sup>
- International United Holding AG, registered in Niue, a small island in the South Pacific with a population of approximately 1,400 people. The entity was incorporated on January 16, 2002, one day after Worldwide Management Corporation, and is registered at No. 2. Commercial Centre Square, Alofi, Niue. Information from the Niue Registry reports that the company was dissolved on December 31, 2006 as a result of the closure of the Niue International Business Companies Registry. Niue's corporate registry was disbanded after international criticism that it was being used exclusively as a haven for money launderers and tax evaders. Shareholder information is not available for International United

<sup>27</sup> Exhibit 189: UA0005784.

<sup>28</sup> Exhibit 190: UA0005806.

Holding. The company's registered agent is listed as The International Trust Company of Niue.<sup>29</sup>

Dennis Smerley is listed on corporate records as affiliated with Worldwide Management Corporation and/or International United Holding.<sup>30</sup> Internet research suggests that Smerley is the Director of International United Holding and Curtis M. Hanson is the Director of Worldwide Management Corporation. The investigative team has not identified a public profile for either Smerley or Hanson except for references to their roles at Worldwide Management and International United Holding. Likewise, it does not appear that either Worldwide Management Corporation or International United Holding conduct any corporate activities. Research suggests that both companies are incorporation agents that work together and have incorporated a number of other entities in the United States.

Olden Group has not filed changes to its members, registered agent or principal address since incorporation. From 2005 to 2010, Olden Group has paid the required annual fee but has not filed any documents to indicate that International United Holding has been dissolved.

The contracts between Interfarm and Olden Group LLC are signed by purported Director O Yaroshuk. Yaroshuk is not named as an officer of the company in corporate records. Because of the common surname, the investigative team was not able to identify a public profile for this individual. Olden Group does not have a public profile with the

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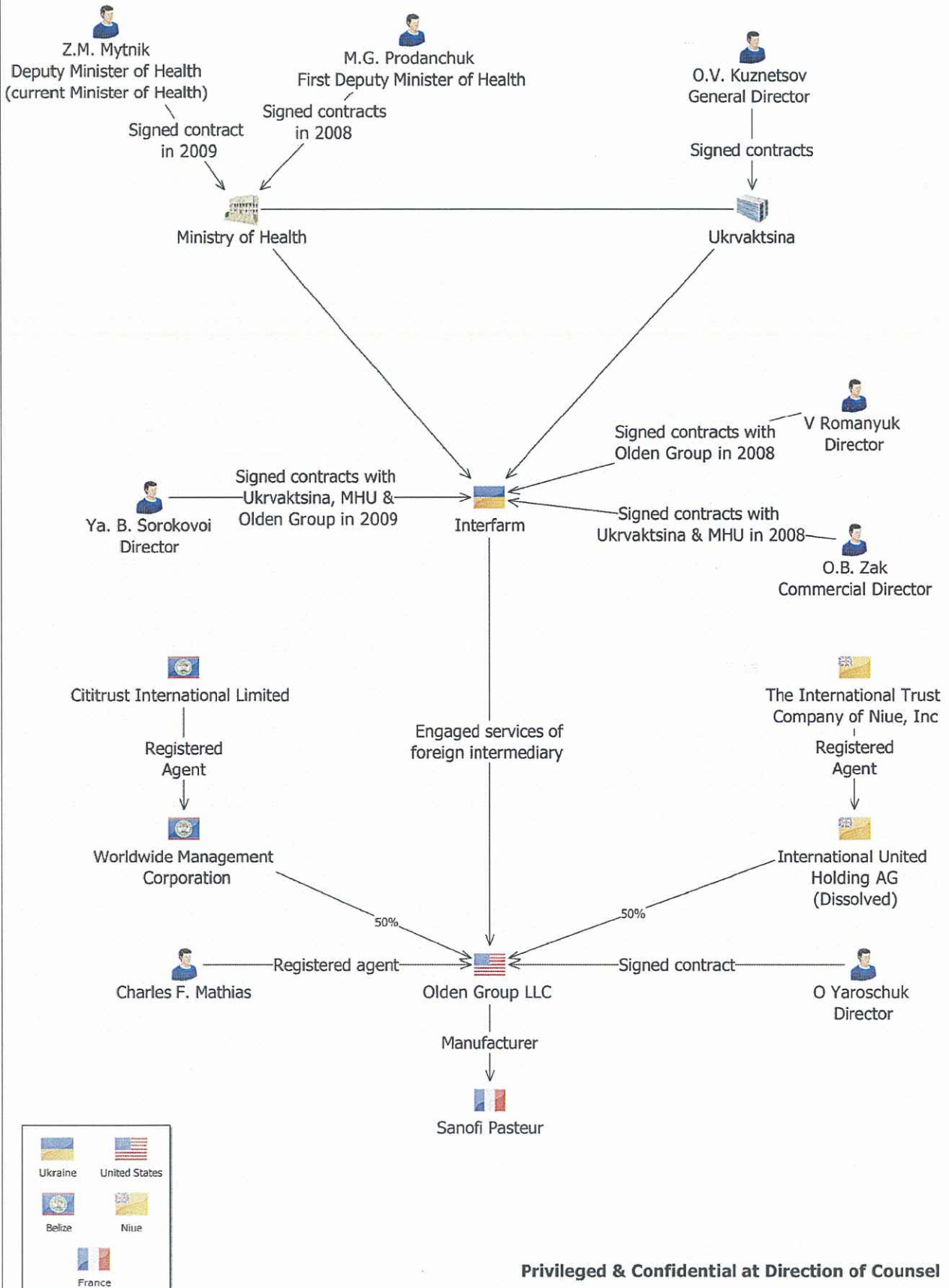
<sup>29</sup> Exhibit 191: UA0005676.

<sup>30</sup> Exhibit 192: UA0005783.

exception of references in Ukraine in the context of its involvement in the procurement of vaccines by the MHU.

The transactions involving the Ministry of Health, Interfarm, and Olden Group, as well as the ownership of the relevant corporations, are illustrated in the chart on the following page.

# Interfarm Contract



Privileged & Confidential at Direction of Counsel

## **B. Imbioimpex**

### **1. *Corporate Profile***

The limited liability company OOO Imbioimpex is among the companies that are well known on the Ukrainian market for supply and distribution of pharmaceuticals and medical products and is one of the top suppliers of medical products under state procurements contracts. Publications have noted that there are only a few main suppliers of vaccines, with Imbioimpex being one of those.<sup>31</sup>

Imbioimpex was incorporated on 7 December 2006 and reports its registered office address as 02160 Kyiv, Dneprovskiy district, prospekt Vossoedineniya 7-a, telephone number 5591027. The company was founded and is currently wholly owned by Aleksey Sergeevich Savchenko. Savchenko is also the head of the company.

Savchenko was formerly head of state-owned enterprise Ukrvaksina, where he accumulated an extensive network of contacts.<sup>32</sup> He began as a Deputy Director when Ukrvaksina was first established circa 1994 and left approximately five years later to join MedAtom, the predecessor of Imbioimpex. Savchenko subsequently returned to Ukrvaksina as General Director but was dismissed a year later and proceeded to set up Imbioimpex.

### **2. *Five Contracts Were Analyzed***

The Investigative Firms reviewed and analyzed the five vaccine procurement contracts between the MHU, Imbioimpex, and the state enterprise Ukrvaksina, including

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<sup>31</sup> Zerkalo Nedeli, 21.11.2009

<sup>32</sup> Interview of confidential source, August 25, 2010.

the tender process and the manner in which the vaccines were supplied. The following five contracts were analyzed:

- Government Contract 1/14 signed on May 27, 2008 for 1,325,230 units of Anti-polio vaccine type 1, 2, 3 at UAH 1.75 per unit. The total value of the contract was UAH 2,319,152.50.<sup>33</sup>
- Government Contract 1/15 signed on May 27, 2008 for 102,830 units of Rabies vaccines at UAH 30.00 per unit. The total value of the contract was UAH 3,084,900.<sup>34</sup>
- Government Contract 1/16 signed on May 27, 2008 for 108,625 units of TB vaccine at UAH 1.80 per unit. The total value of the contract is UAH 195,525.<sup>35</sup>
- Government Contract 1/7 signed on February 9, 2009 for 57,200 units of Rubella vaccine at UAH 30.00 per unit. The total value of the contract is UAH 1,716,000.<sup>36</sup>
- Government Contract 1/10 signed on February 9, 2009 for 1,041,100 units of Anti-polio vaccine type 1, 2, 3 at UAH 2.90 per unit. The total value of the contract was UAH 3,019,190.<sup>37</sup> The unit price of the vaccine has increased almost 66% since 2008 when the price of one unit was UAH 1.75 (Government Contract 1/14).

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<sup>33</sup> Exhibit 193: UA0001042.

<sup>34</sup> Exhibit 194: UA0001053.

<sup>35</sup> Exhibit 195: UA0001063.

<sup>36</sup> Exhibit 196: UA0001102.

<sup>37</sup> Exhibit 197: UA0001117.

### 3. *There Were Significant Irregularities in the Tender Process*

On each of the five tenders, Imbioimpex was the lowest bidder. The only other bidders on the tenders won by Imbioimpex were MedAtom, Interfarm, and Tri-TsAS.<sup>38</sup> However, the addresses of Imbioimpex and MedAtom are identical.<sup>39</sup> Although the two entities purport to list different phone numbers, both numbers when dialed reach Imbioimpex. When investigators contacted the number listed for MedAtom, the respondent on the phone stated that it was the number of Imbioimpex and the address of the entity was Office 223, 7-a Vozzyednannya. Another call was made to the number listed as Imbioimpex, and the same individual that answered the first call, again confirmed that the address of the entity that was reached was Office 223, 7-a Vozzyednannya. A source indicated that Imbioimpex was the predecessor to MedAtom and that the entity's director, Aleksey Savchenko, has worked for both companies.<sup>40</sup> This strongly suggests that Imbioimpex used MedAtom to create the appearance of competition in the tender process.

In four out of five tenders, Imbioimpex's bid price was higher than the available budget of the MHU to spend on the specified vaccine. In the acceptance to Imbioimpex, MHU stipulate that fewer vaccines are to be acquired than stated in the initial tender documents, in order to ensure that the budgetary limit is not exceeded.

Moreover, in one instance – the rabies vaccine tender in April 2008 – Imbioimpex bid exactly the same amount for the tender as was available in the government budget

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<sup>38</sup> See generally Exhibit 198: UA0003114.

<sup>39</sup> *Id.*

<sup>40</sup> Interview of confidential source, August 25, 2010.



(UAH 3,084,900).<sup>41</sup> One reasonable conclusion is that Imbioimpex knew the budget limit in advance of submitting its tender.

4. *The Government Contracts Obtained by Imbioimpex Totaled More Than UAH 10 Million*

The total value of the five contracts amounts to UAH 10,334,767.50. The first three government contracts, all signed in 2008, stipulated that Ukrvaksina shall make a 100 percent prepayment of the total price of the goods to Imbioimpex. The latter two contracts, both signed in 2009, stipulate that the payment of the goods shall be made within seven days from the date of delivery of the goods.

The contracts are signed by Deputy Minister of Health Z.M. Mytnyk on behalf of MHU and General Director O.S. Savchenko on behalf of Imbioimpex.

5. *Imbioimpex Entered Into Sham Contracts with Foreign Shell Companies To Disguise Mark-Ups*

Imbioimpex entered into four contracts with a New Zealand entity called Hostas Limited and one contract with a Seychelles company named Virion GmbH, relating to the MHU contracts.<sup>42</sup> The contracts and invoices instructed Imbioimpex to transfer payment to Hostas' bank account in Latvia and to Virion's bank account in Lithuania.<sup>43</sup>

Hostas Limited is a classic shell company. Hostas was incorporated on June 11, 2007,<sup>44</sup> six months after Imbioimpex was incorporated. Hostas is registered at 69 Ridge Road, Albany, Auckland, which is the registered office address of Company Net

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<sup>41</sup> See Exhibit 198 (cited above).

<sup>42</sup> Exhibit 199 : UA0001076; Exhibit 200: UA0001084; Exhibit 201: UA0001111; Exhibit 202: UA0001128; Exhibit 203: UA0001093.

<sup>43</sup> Exhibit 204: UA0002668-2675.

<sup>44</sup> Exhibit 205: UA0005672.

Limited,<sup>45</sup> a New Zealand-based company formation agent. Hostas listed a different address on the contracts with Imbioimpex at Unit C, 396 Rosedale Road, Albany, Auckland, New Zealand. This is the address of Register a Company,<sup>46</sup> an online company registration website.<sup>47</sup> The original application to incorporate Hostas Limited was submitted by Register a Company.

The address for communication for Hostas Limited is provided in its most recent annual filing as PO Box 301135, Albany, Auckland,<sup>48</sup> which is the postal address for Company Net as listed on Company Net's website.<sup>49</sup> At the time of incorporation, the address for communication provided for Hostas was in Latvia at 22 Antonijas Str, 21 Riga LV-1010. Research indicates that more than 140 companies are registered at this address.

Hostas submitted filings declaring it to be inactive during the accounting periods ending March 31, 2008 and March 31, 2009.<sup>50</sup> This was during the period that Imbioimpex contracted with Hostas. Hostas does not have a public profile, and no website has been identified for the entity. In the contracts with Imbioimpex, Hostas is represented by the purported company President, Oliver Pen. Pen does not have a public profile and is not connected to Hostas in corporate records, and no individual by that name has been identified in New Zealand. The sole director and shareholder of the company is an individual resident in Panama who is an officer of at least seventeen

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<sup>45</sup> Exhibit 206: UA0005675.

<sup>46</sup> Exhibit 207: UA0005985.

<sup>47</sup> Exhibit 208: UA0005989.

<sup>48</sup> Exhibit 209: UA0005671.

<sup>49</sup> Exhibit 210: UA0005990.

<sup>50</sup> Exhibit 211: UA0005673; Exhibit 212: UA0005674.

entities. This individual's profile suggests that she is working as an incorporation agent and a nominee officer rather than beneficial owner of these entities. Prior to April 2009, the company was wholly owned by Bestwide Enterprise SA, which is registered at the same address as Hostas' director in Panama. The address is also shared by Panama Legal Consultants, a Panamanian law firm providing offshore incorporation services.<sup>51</sup>

Virion GmbH was incorporated on November 11, 2005 and is registered at 306 Victoria House, Victoria, Mahe, Seychelles.<sup>52</sup> This is the address of its agent, the Seychelles incorporation agency Intershore Consult (Pty) Ltd.<sup>53</sup> The company's website reports that Intershore Consult incorporates entities in offshore jurisdictions including the Seychelles, Belize and Panama.<sup>54</sup>

In the contracts with Imbioimpex, Virion is also represented by the company Director, Oliver Pen, who is also the company President at Hostas Limited. Pen does not appear to have a public profile. The company's status is registered as "not in good standing" as it has failed to pay the annual registration fee.

6. *Pricing Data Strongly Suggests that Actual Mark-Ups Exceeded 10% Limit*

In total, MHU paid a mark-up of UAH 554,004.49 on the five contracts with Imbioimpex. However, that figure does not begin to capture the true mark-ups, which evidence suggests that Imbioimpex concealed by using another layer of intermediaries, Hostas and Virion. Confidential sources revealed manufacturers' prices to be substantially lower than the prices charged by Imbioimpex. For example, whereas the

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<sup>51</sup> Exhibit 213: UA0005991.

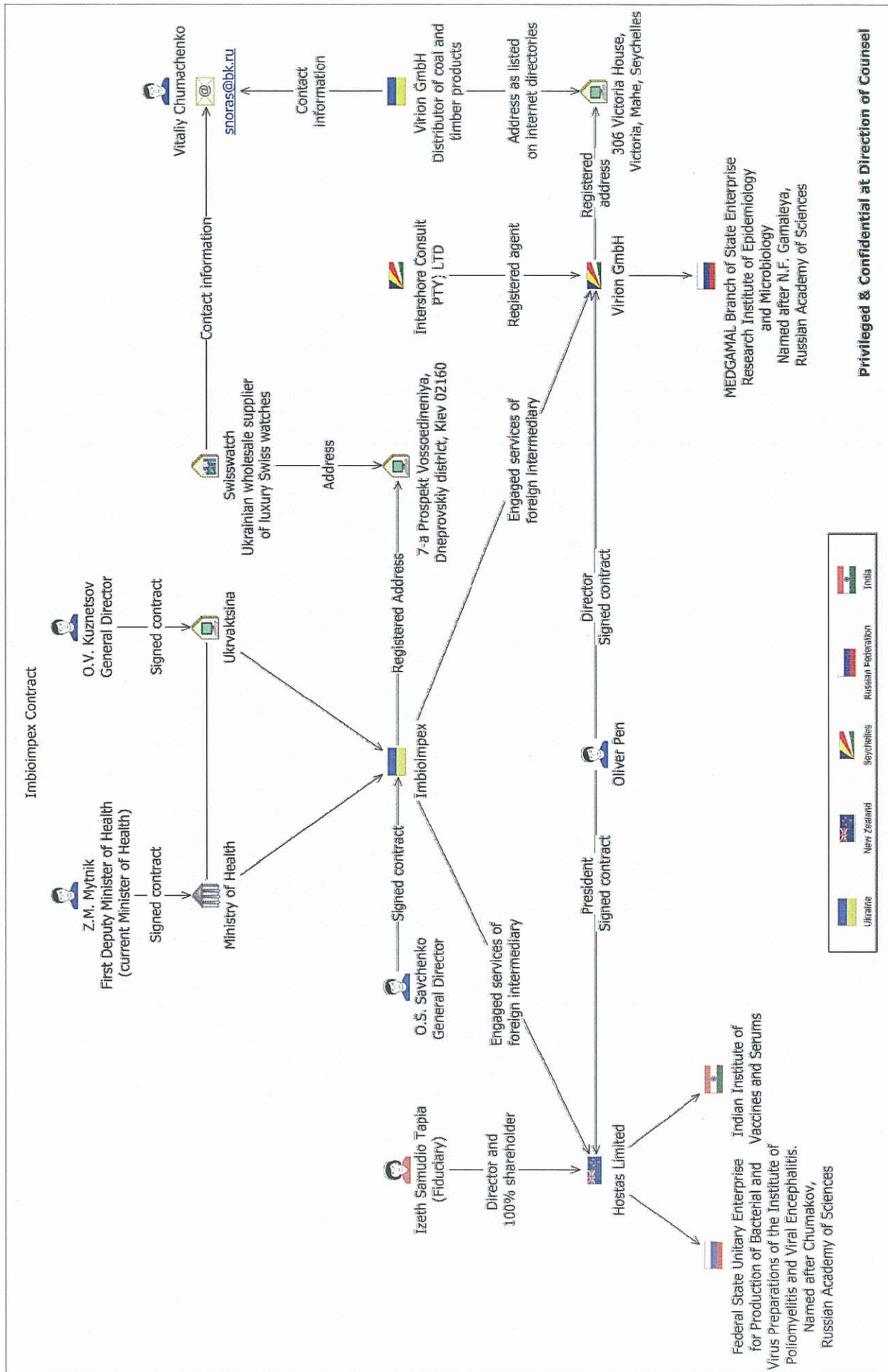
<sup>52</sup> Exhibit 214: UA0005805.

<sup>53</sup> Exhibit 215: UA0005993.

<sup>54</sup> Exhibit 216: UA0005998.

MHU paid UAH 30 per dosage of rubella vaccine, and Imbioimpex reported that it paid UAH 29.65, research revealed that a manufacturer's price should have been approximately UAH 9.48, meaning that Imbioimpex may have marked up the vaccines by 300 percent.

The transactions involving the Ministry of Health, Imbioimpex, Hostas, and Virion, as well as the ownership of the relevant corporations, are illustrated in the chart on the following page.



**C. United Medical Service**

**1. *Corporate Profile***

United Medical Service (“UMS”) was initially incorporated as Elsint Medical Service on August 11, 1997, and changed its name on December 30, 1999. United Medical Service identifies itself as an exclusive distributor for Chinese company Beijing Wandong Medical Equipment Co., Ltd, and an official distributor for the US company Codonics Inc. and the Japanese company Konica Minolta. United Medical Service is reported as a winner of a number of tenders, including a UAH 30 million contract for the supply of medical, orthopedic and surgical equipment for roentgen diagnostics with the MHU in October 2008.

**2. *Government Contracts***

The Ministry of Health of Ukraine, United Medical Service Limited, and the state enterprises Urkmedpostach or Politechmed entered into three trilateral contracts in relation to the provision of medical equipment:

- Government Contract No 13IT, signed on December 3, 2007, for 29 units of Diagnostic Radiography Systems HF 51, KODAK Point of care CR 140 System and KODAK Dry View 8150 Laser Imager. The total value of the contract was UAH 34,626,000.<sup>55</sup> The manufacturers under this contract are stipulated as Beijing Wandong Medical Equipment Co Ltd (China) for the HF51 system and Caresteam Health Inc (USA), Orex Computed Radiography Ltd (Israel), Agfa-

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<sup>55</sup> Exhibit 217: UA0002676-2682.

Cevaert HealthCare GmbH (Germany), ContextVision AB (Sweden), Rayco Medical Products Company Limited (China) for the KODAK equipment.

- Government Contract No. 76T-2008, signed on October 16, 2008, for 26 units of X-Ray Diagnostic Systems HF 51 and medical dry-ink printer Horizon GS. The total value of the contract was UAH 30,758,000.<sup>56</sup> The manufacturers under this contract are Beijing Wandong Medical Equipment Co Ltd (China) and Codonics Inc (USA).
- Government Contract No 112T-2008, signed on October 31, 2008, for 2 units of Magnetic Resonance Diagnostic System i\_open 0.36T and Medical Dry-Ink Printer Horizon GS. The total value of the contract was UAH 10,750,000.<sup>57</sup> The manufacturers under this contract were Beijing Wandong Medical Equipment Co Ltd (China) and Codonics Inc (USA).

The total value of the three contracts was UAH 76,134,000. All three contracts stipulate that the state enterprise shall make a 100% prepayment of the total price of the goods to United Medical Service. On behalf of the MHU, the first contract in 2007 is signed by Deputy Minister of Health B.G. Bidnyy, and the two contracts in 2008 are signed by Deputy Minister of Health Z.M. Mytnik. Each contract is signed by General Director O.V. Mayboroda on behalf of United Medical Services.

### 3. *Contracts with Foreign Shell Companies*

United Medical Service entered into four contracts with a UK entity called Jade Commercial that related to UMS' contracts with the MHU. The total value of those four

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<sup>56</sup> Exhibit 218: UA0002751-2758.

<sup>57</sup> Exhibit 219: UA0002718-2725.

contracts was US\$9,714,283.72.<sup>58</sup> The Investigative Firms did not review any evidence that would suggest that Jade Commercial performed any work or added any value under the contract. Instead, a reasonable conclusion is that Jade Commercial existed merely to conceal the manufacturers' prices and enable UMS to earn a larger profit.

Moreover, UMS and Jade entered into sham "supply" contracts well before UMS was awarded the trilateral contracts with the Ministry. As reflected in the chart below, the sham contracts were executed between 113 and 278 days before the government contracts between UMS and the government, and are for the exact same quantity of goods.

<b>Government Contract</b>	<b>Sham Contracts Between UMS and Jade</b>	<b>Days by Which Sham Contract Preceded Government Contract</b>
- <b>Oct. 16, 2008</b> , No. 76T-2008. Parties: UMS, Ministry of Health and Politehkmed. Materials: 26 X-ray machines & 26 printers. Value: UAH 30,758,000.	- <b>March 3, 2008</b> , No. 0108-COM-UA. Parties: UMS & Jade. Materials: 26 X-ray machines & 26 printers. Value: UAH 30,370,984	228
- <b>Oct. 31, 2008</b> , No. 112T-2008. Parties: UMS, Ministry of Health and Politehkmed. Materials: 2 MRI Machines & 2 Printers. Value: UAH 10,750,000	- <b>July 10, 2008</b> , No. 0208-UA. Parties: UMS & Jade. Materials: 2 MRI Machines & 2 Printers. Value: UAH 5,330,270  - June 2, 2008 No. 0108-UA. Parties: UMS & Jade. Materials: 8 printers. Value UAH 426,756	113  151
- <b>Dec. 3, 2007</b> , No. 131T-2007. Parties: UMS, Ministry of Health, Ukrmedpostach. Materials: 29 x-ray diagnostic systems sets, including x-ray, digital radiography system, & simulated luminophors. Value: UAH 34,626,000	- <b>March 1, 2007</b> , 0107-UA. UMS & Jade. Materials: 29 x-ray diagnostic systems sets, including x-ray, digital radiography system, & simulated luminophors. Value: UAH 23,139,100	278

<sup>58</sup> Exhibit 220: UA0002702-2710; Exhibit 221: UA0002759-2769; Exhibit 222: UA0002743; Exhibit 223: UA0002726-2735.



After receiving payment in full from the government, UMS wired funds from its bank account in Ukraine to Jade's account in Latvia. The sham contracts between UMS and Jade also serve to shield the manufacturer prices and, therefore, to minimize the reported markups. Therefore, the true markups are significantly higher than the difference between the UMS sale price and the Jade sale price.

UMS also contracted with Emansis, a Ukrainian company, for the supply of equipment. The total value of the contract was UAH 11,486,900. Juri Vitman, the sole director of Eurostate Corporation, which is the foreign intermediary on the Tri-TsAS contracts as described below, is also a director of an entity in the UK called Emansis Limited, which is registered at the same address in London as Eurostate.<sup>59</sup>

#### 4. *Jade Commercial Limited*

Jade Commercial Limited was incorporated on December 18, 1998 in the UK and is registered at Suite 3, 1 Duchess Street, London W1W 6AN.<sup>60</sup> This is the same address as Legal Business Consultants in the UK, which was mentioned above as the supplier of vehicles to ISS Ukraina that were ultimately supplied to the Ministry of Emergency Situations. On contracts and invoices to United Medical Service, Jade Commercial lists a different address at 10 Cromwell Place, South Kensington, London, SW7 2JN. This is the registered address of the company's shareholders.

Jade Commercial was dormant until 2002 and has only filed abbreviated accounts since that date. For the year ending December 31, 2009, Jade reported net assets of

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<sup>59</sup> Exhibit 224: UA0005640.

<sup>60</sup> Exhibit 225: UA0005743.

£44,054 compared with £39,917 in 2008.<sup>61</sup> The company does not have a website or a public profile.

Michael Stuart Ross, a British national, has been the company director since February 12, 2009.<sup>62</sup> Ross signed the four contracts on behalf of Jade Commercial with United Medical Service. Ross does not have any other current UK appointments; however, in the early 1990s he was a director of Heathfield Terminal Company Limited, where his occupation was listed as a marketing operations manager.<sup>63</sup>

Prior to February 2009, the directors of Jade Commercial were:

- Legal Directors Ltd (Comp NBR 3368733) from incorporation to 9 June 2003.
- Legal Directors Limited from 25 June 2003 to 3 August 2006.
- Subscriber Directors Limited from 3 August 2006 to 12 February 2009.

All three entities are registered at 10 Cromwell Place, South Kensington SW7 2JN, the same address as listed for Legal Business Consultants. According to its latest annual return filed in December 2009, Jade Commercial was owned at that time by Legal Directors Limited and Legal Secretaries Limited.<sup>64</sup> Both companies were joint shareholders of Jade Commercial during the period of the contracts with United Medical. However, both entities were dissolved in 2009. Legal Directors Limited was dissolved on March 24, 2009 and had not traded since its incorporation on June 24, 2003.<sup>65</sup> Legal Secretaries was dissolved on December 22, 2009 and also had not traded since its

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<sup>61</sup> Exhibit 226: UA0005739.

<sup>62</sup> Exhibit 227: UA0005774.

<sup>63</sup> Exhibit 228: UA0005773.

<sup>64</sup> See Exhibit 226, cited above.

<sup>65</sup> Exhibit 229: UA0005771.

incorporation on May 9, 1997.<sup>66</sup> Legal Secretaries Limited's occupation is listed as a formation agent in UK corporate filings. That entity acted as the secretary for a number of entities affiliated with the directors of Legal Business Consultants, including Diligent Data Limited, Legal Business Consultants, and Tynney Directors Limited.

#### 5. *Pricing Data*

In total, MHU paid a mark-up between UAH 1,132,237.62 and UAH 1,141,936.62 on the three contracts with UMS. However, that figure does not begin to capture the true mark-ups over the manufacturer's price, which UMS did not have to report because UMS used another layer of intermediaries, including Jade Commercial. Confidential sources revealed manufacturers' prices to be substantially lower than the prices charged by UMS, as reflected by the estimates in the following chart.

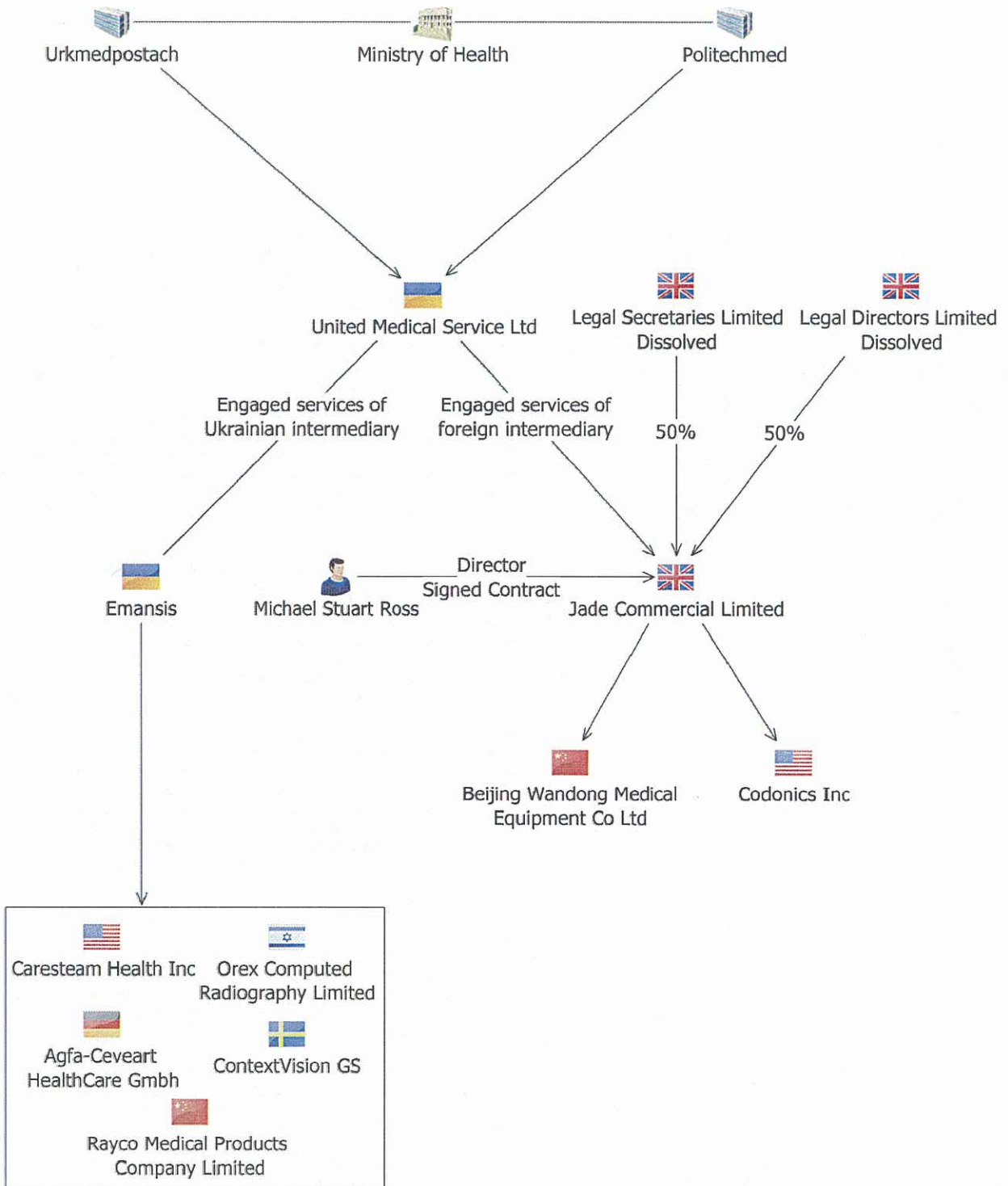
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<sup>66</sup> Exhibit 230: UA0005772.

Equipment	Manufacturer	Govt contract	Imbiolimpex contract	Govt price		UMS Price		Manufacturer's price	
				UAH	USD	UAH	USD	UAH	USD
Diagnostic Radiography Systems HF 51	Beijing Wandong Medical Equipment Co Ltd (China)	No. 131T	No. 0107-UA	1,194,000.00 rph.	\$236,435.64	797,900.00 rph.	\$158,000	481,412.01 UAH - 923,364.02 UAH	\$61,000-\$117,000
KODAK Point of care CR 140 System and KODAK Dry View 8150 Laser Imager	Caresteam Health Inc (USA), Orex Computed Radiography Ltd (Israel), Agfa-Cevaert HealthCare GmbH (Germany), ContextVision AB (Sweden), Rayco Medical Products Company Limited (China)		0109-2007			396,100.00 rph.	\$78,435.64	Not available	Not available
X-Ray Diagnostic Systems HF 51	Beijing Wandong Medical Equipment Co Ltd (China)	No. 76T-2008	0108 COM-UA	1,183,000.00 rph.	\$167,326.73	1,094,964.79 rph.	\$142,203.22	481,412.01 UAH - 923,364.02 UAH	\$61,000-\$117,000
Medical dry-ink printer Horizon GS	Codonics Inc (USA)					73,150.00 rph.	\$9,500.00	Not available	Not available
Magnetic Resonance Diagnostic System i_open 0.36T	Beijing Wandong Medical Equipment Co Ltd (China)	No 112T-2008	0208UA	5,375,000.00 rph.	\$1,109,230.86	4,482,272.50 rph.	\$925,000.00	3,482,702.15 rph.	\$441,027.18
Medical Dry-Ink Printer Horizon GS	Codonics Inc (USA)		0108UA			48,495.00 rph.	\$10,000.00	Not available	Not available
						58,194.00 rph.	\$12,000.00	Not available	Not available

The transactions involving the Ministry of Health, United Medical Service, Emansis, and Jade, as well as the ownership of the relevant corporations, are illustrated in the chart on the following page.

# United Medical Service Contract



Privileged & Confidential at Direction of Counsel

**D. Tri-Tsentralny Aptechny Sklad**

**1. *Summary of Key Findings***

- Use of Foreign Intermediaries and No Work Contracts To Create the Appearance of Complying With Ukrainian Law Limiting Mark-ups and Evading Taxes: Six government contracts between Tri-Tsentralny Aptechny Sklad (“Tri-TsAS”), the Ministry of Health (MHU), and Ukrvaksina were reviewed. The six contracts totaled UAH 165,015,071.48. On paper, Tri-TsAS marked the vaccines up UAH 3,933,946.35 over their customs value, or 2.44 percent. However, Tri-TsAS claimed to have bought the vaccines through foreign intermediaries and thereby avoided having to report the manufacturer’s prices. Tri-TsAS appeared to comply with Ukrainian law limiting pharmaceutical mark-ups to 10 percent but was masking its true profit.
- Tri-TsAS Entered Into Contracts With Foreign Intermediaries Before It Won MHU Tenders: Tri-TsAS informed the government that Tri-TsAS had purchased four of the vaccines from a UK company called Eurostate Corporation. However, the evidence reviewed does not show that Eurostate performed any services, suggesting that Eurostate was present merely to conceal the actual purchase price. A \$20 million contract between Tri-TsAS and Eurostate was signed on February 1, 2008, over a month before any contract between Tri-TsAS and the MHU.
- Prepayments Ultimately Transferred to Latvian Bank Accounts: Tri-TsAS was usually paid in full by Ukrvaksina well in advance of supplying the vaccines. Tri-TsAS then wired the vast majority of funds received into Eurostate’s Latvian

bank account. Eurostate's director is a Latvian incorporation agent, Juri Vitman.<sup>67</sup> Vitman is also a director of a UK company called Emansis, which contracted with United Medical Service (UMS) in relation to the purchase of medical equipment for Ukraine.

- Lack of Competition: Tri-TsAS and another Ukrainian entity and frequent government contractor, Ganza, appeared to compete with each other on tenders won by Tri-TsAS. But after winning the "competition," Tri-TsAS turned around and purchased many of the vaccines from Ganza. Another so-called competitor was an affiliate of Tri-TsAS.

## *2. Corporate Profile*

Tri-TsAS is well known on the Ukrainian market for supply and distribution of pharmaceuticals and medical products and is among the top-suppliers of medical products under state procurements contracts. According to corporate records, the limited liability company OOO Tri-Tsentrally aptekny sklad was incorporated on February 11, 1997 and was assigned state registration number 24725736. Tri-TsAS maintains an official website at <http://www.tricas.com.ua/>, according to which Tri-TsAS has been operating on the Ukrainian pharmaceutical market since 1996.

Dmitry Alekseevich Zavtur is reported as current head of the company. The current shareholders are Gennady Nikolaevich Chernichenko (60%), Maksim Borisovich Gromov (15%), and Zavtur (25%). Tri-TsAS' website states that it is an official

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<sup>67</sup> Exhibit 231: UA0005667.

distributor for Belgian company GlaxoSmithKline and many other Ukrainian and foreign companies.

References were found to Tri-TsAS winning tenders for state procurement of cancer medications as early as August 2000.<sup>68</sup> In 2009, Tri-TsAS, together with Interfarm and Ganza, was included into the top five contractors for state procurement by MHU. Tri-TsAS was reported to have received UAH 137.9 million worth of orders in 2009.<sup>69</sup> In May 2010, the Ministry of Economics published information about contracts to procure vaccines that MHU concluded between April 13-15, 2010. Tri-TsAS was reported as among the largest recipient of funds, obtaining UAH 10.2 million. According to the Ministry of Economics, Farma Life, which was identified as an affiliate of Tri-TsAS, received UAH 80.6 million. Farma Life was the only other company that competed with Tri-TsAS on several of the vaccine tenders under investigation.

### 3. *Bidding Process*

The following chart shows the bidders that participated in the tender process for each of the six contracts involving Tri-TsAS that were reviewed.

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<sup>68</sup> Exhibit 232: UA0005999.

<sup>69</sup> Дело (Киев) ; 03.02.2010



No.	Vaccine	Bidder	Bid Price	Manufacturer
1	Hiberix	Tri-Centralny Aptechny Sklad LLC	20,309,121.00 грн.	GlaxoSmithKline Biologicals s.a.
		Farm-BS LLC	12,295,710.00 грн.	Centre of Genetic Engineering and Biotechnology, National centre of Bio Apparatus, Cuba
		Farma Life	20,563,515.00 грн.	GlaxoSmithKline Biologicals s.a.
		Interfarm LLC	22,047,480.00 грн.	Sanofi Pasteur
2	Infanrix	Tri-Centralny Aptechny Sklad LLC	35,227,696.00 грн.	GlaxoSmithKline Biologicals s.a.
		Farma Life	35,964,315.00 грн.	GlaxoSmithKline Biologicals s.a.
		Interfarm LLC	36,830,925.00 грн.	GlaxoSmithKline Biologicals s.a.
3	SSI/BCG	Tri-Centralny Aptechny Sklad LLC	6,712,640.00 грн.	Statens Serum Institute
		Interfarm LLC	7,628,000.00 грн.	Statens Serum Institute
4	Hiberix	Tri-Centralny Aptechny Sklad LLC	42,444,480.00 грн.	GlaxoSmithKline Biologicals s.a.
		Farma Life	44,571,000.00 грн.	GlaxoSmithKline Biologicals s.a.
5	Infanrix	Tri-Centralny Aptechny Sklad LLC	71,904,400.00 грн.	GlaxoSmithKline Biologicals s.a.
		Farma Life	76,380,000.00 грн.	GlaxoSmithKline Biologicals s.a.
6	SSI/BCG	Tri-Centralny Aptechny Sklad LLC	14,271,488.00 грн.	Statens Serum Institute
		Ganza	14,717,472.00 грн.	Statens Serum Institute

On five of the six tenders, Tri-TsAS was the lowest bidder. The only other bidders on the tenders won by Tri-TsAS were Interfarm, LLC, Farma-Life, Farm-BS LLC, and Ganza. As indicated above, it has been suggested that Farma Life and Tri-TsAS were affiliated and that there was no real competition between them.

Similarly, Tri-TsAS and Ganza competed for the SSI vaccine tender, which was valued at UAH 14.27 million. Tri-TsAS won the tender but then purchased all of the vaccines from Ganza. One inference to be drawn from this activity is that Tri-TsAS and Ganza colluded in submitting their bids so that both companies could benefit. Ganza, along with Tri-TsAS and Interfarm, was also included in a list of the top five contractors for state procurement by the MHU. Ganza received UAH 188.5 million worth of orders in 2009.<sup>70</sup> Ganza was founded by and is currently co-owned by Mikhail Dmitrievich Kuchirk and Petro Ivanovich Bagriy. Bagriy is a business partner of Yuri Konstantinov, the Head of the MHU's department on regulatory policy in the area of turnover of medications in the healthcare system.<sup>71</sup> Bagriy and Konstantinov co-founded together TOV Matrix and TOV Emergencia 2004. This represents a potential conflict of interest when Ganza bids on a MHU tender.

In all six tenders, Tri-TsAS's bid price was higher than the available budget of the MHU to spend on the specified vaccine. The tender procedures do not permit the MHU to negotiate with a bidder for a lower price. Instead, the MHU must accept the lowest offer that meets all the published requirements, so long as there are at least two bidders. If the lowest bid exceeds the budgeted amount, the MHU purchases fewer vaccines so

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<sup>70</sup> Дело (Київ) ; 03.02.2010

<sup>71</sup> *Id.*

that the overall budget allotments are not exceeded. This system creates an incentive for bidders to collude and fix the tender process. This is especially likely where there are only two bidders, as there were for four of the six Tri-TsAS contracts.

#### 4. *Government Contracts*

The investigation analyzed the following six government contracts between the Ministry of Health of Ukraine, the Ukrainian intermediary Tri-TsAS, and the state enterprise Ukrvaksina, in relation to the provision of medical vaccines:

- Government contract No 1/5, signed on March 19, 2008 for the supply of 416,023 units of Hiberix at a unit price of UAH 47.90 per unit. The contract specifies that the vaccines will be acquired from GlaxoSmithKline Biologicals, Belgium. The total value of the contract was UAH 19,927,501.70.<sup>72</sup>
- Government contract No 1/9 signed on March 20, 2008 for the supply of 424,777 units of Infanrix at a unit price of 81.30 per unit. The contract specifies that the vaccines will be acquired from GlaxoSmithKline Biologicals, Belgium. The total value of the contract was UAH 34,534,370.10.<sup>73</sup>
- Government contract No 1/11 signed on May 13, 2008 for the supply of 610,240 units of SSI/BCG Vaccine at a unit price of UAH 11 per unit. The contract specifies that the vaccines will be acquired from Statens Serum Institut, Denmark. The total value of the contract was UAH 6,712,640.<sup>74</sup> This contract was amended

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<sup>72</sup>Exhibit 233: UA0000932-940.

<sup>73</sup> Exhibit 234: UA0001028-32.

<sup>74</sup> Exhibit 235: UA0002588-98.

on May 14, 2008 reducing the number of vaccines to 582,918 and the total contract value to UAH 6,412,098.

- Government contract No 1/3 signed on February 9, 2009 for the supply of 450,000 units of Hiberix at a unit price of UAH 79.04 per unit. The contract specifies that the vaccines will be acquired from GlaxoSmithKline Biologicals, Belgium. The total value of the contract was UAH 35,568,000. However, an additional agreement was signed on May 25, 2009, which changed the price to UAH 78.18, bringing the total contract value to UAH 35,181,000 for 450,000 units of Hiberix.<sup>75</sup>
- Government contract No 1/5 signed on February 9, 2009 for the supply of 450,000 units of Infanrix at a unit price of UAH 134.15 per unit. The contract specifies that the vaccines will be acquired from GlaxoSmithKline Biologicals, Belgium. The total value of the contract was UAH 60,367,500.<sup>76</sup> Six additional agreements were signed between July and October 2009 which recalculated the price per unit of the vaccines. The final contract value amounted to UAH 59,348,856.79 for 433,391 units at a price per unit of UAH 136.94.
- Government contract No 1/4, signed on February 9, 2009 for the supply of 497,940 units of SSI/BCG Vaccine at a unit price of UAH 17.60. The contract specified that the vaccines would be acquired from Statens Serum Institut, Denmark. (Ganza is the licensed distributor in Ukraine for Statens Serum Institut.) The total value of the contract was UAH 8,763,744. However, an additional

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<sup>75</sup> Exhibit 236: UA0002609-19.

<sup>76</sup> Exhibit 237: UA0002620-35.

agreement was signed on June 4, 2009, which made the total value of the contract UAH 8,713,285.20 – an average price per unit of UAH 17.50.<sup>77</sup>

The total value of the six contracts amounted to UAH 165,015,071.48. The first three contracts in 2008 stipulated that Ukrvaksina shall make a 100% prepayment of the total price of the goods to Tri-TsAS. The latter three contracts in 2009 provided that payment should be made within seven business days from the date of delivery.

The six government contracts were signed by General Director O.V. Kuznetsov on behalf of the State enterprise Ukrvaksina and Director, Alla Volodymyrivna Tkachenko on behalf of Tri-TsAS. On behalf of the MHU, the first two contracts were signed by First Deputy M. Prodanchuk and the latter four contracts were signed by First Deputy Z.M. Mytnyk.

#### 5. *Contracts with Foreign Shell Company*

Tri-TsAS purported to fulfill four of the six government contracts by engaging the services of a UK-registered entity called Eurostate Corporation Limited. Tri-TsAS claimed that the remaining two contracts were supplied by Ukrainian entity Ganza.<sup>78</sup> There is no evidence that Eurostate or Ganza performed any work on the contracts. They did not manufacture the goods. They did not ship the goods. They did not take possession of the goods. Rather, the most reasonable conclusion to draw is that Eurostate and Ganza served entirely to hide the manufacturer's prices and enable Tri-TsAS to markup the price that it had paid by more than 10 percent.

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<sup>77</sup> Exhibit 238: UA0001010-20.

<sup>78</sup> Exhibit 239: UA0001022; Exhibit 240: UA0002599.

Tri-TsAS signed one agreement with Eurostate and two agreements with Ganza that related to Tri-TsAS contracts with the MHU. Payment to Eurostate was made to its bank account in Latvia,<sup>79</sup> a known money laundering jurisdiction. Tri-TsAS signed the agreement with Eurostate – Contract №GB/TRY-02-2008, dated February 1, 2008 for US\$20,000,000 – before the first government contract was signed.<sup>80</sup>

Eurostate Corporation Limited was incorporated in the UK on January 25, 2002. It is registered at 48 Queen Anne Street, London W1G 9JJ. Eurostate shares this address with many other UK companies, including Emansis UK. Eurostate provided a second UK address on the contract and invoices at 39 Wetherby Mansions, Earls Court Square, London, SW5 9BH. Similarly, multiple UK companies are registered at this address.

According to the most recent annual accounts of Eurostate Corporation for the year ending January 31, 2010, the company's principal business activity is serving as a trade agent for pharmaceutical goods, for which it receives commission.<sup>81</sup> In 2008, the year in which Tri TsAS signed a contract for US \$20 million with Eurostate, the company only recorded income from ordinary activities of £1,900.<sup>82</sup> This income is categorized as commission. In 2009, income from commission is recorded as £1,880.

This filing is inconsistent with the sales figures Tri-TsAS reported to the Ukrainian government through contracts and customs forms.

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<sup>79</sup> See, e.g., Exhibit 241: UA0002659; Exhibit 242: UA0002663; Exhibit 243: UA0002664.

<sup>80</sup> Exhibit 244: UA0000944-47.

<sup>81</sup> Exhibit 245: UA0005664.

<sup>82</sup> Exhibit 246: UA0005661.

Juri Vitman, a Latvian national, was appointed as a director of the company on September 27, 2008. Vitman has 218 other appointments at UK companies.<sup>83</sup> His occupation is listed as a business consultant. His most recent address is listed in Dublin, Ireland. Vitman does not have a public profile online or in the media. Vitman is also a director of a UK company called Emansis Limited. As noted above, United Medical Services contracted with Emansis in relation to the purchase of medical equipment.

The contracts with Tri TsAS are signed by Vadim Simakov on behalf of Eurostate Corporation Limited. Simakov is not associated with Eurostate Corporation in corporate records and no public profile has been identified for him.

Eurostate has been owned by a shell company called Transhold Corporation Limited, which is based in Hong Kong. Transhold, in turn, is owned by two shell companies located in the Bahamas, Inhold Ltd. and Multihold Ltd.<sup>84</sup> None of these companies carries on any business. The companies were created by Aall & Zyleman Company Limited, a Hong Kong based entity that advertises itself as a specialist in offshore incorporation and tax avoidance. Transhold's company secretary is Bonita LLC, which is registered in Oklahoma, USA.<sup>85</sup> The initial shareholders of Bonita were two Irish shell companies, Ireland & Overseas Acquisitions and Milltown Corporate Services, which were dissolved in 2003<sup>86</sup> and 2005,<sup>87</sup> respectively. The directors of the Irish entities were two Latvian fiduciary directors, Stan Gorin and Erik Vanagels.

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<sup>83</sup> Exhibit 247: UA0005746.

<sup>84</sup> Exhibit 248: UA0005788.

<sup>85</sup> Exhibit 249: UA0005603.

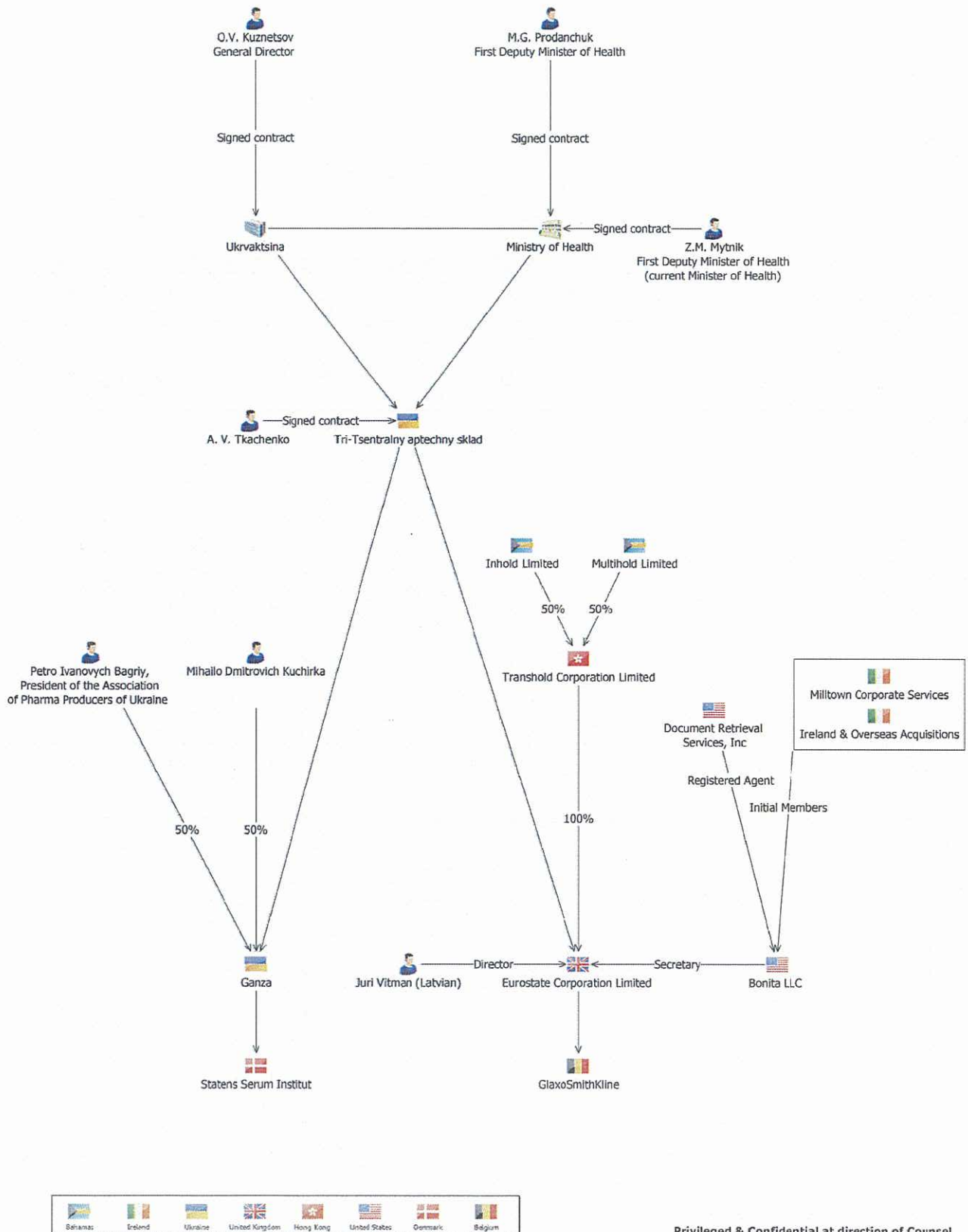
<sup>86</sup> Exhibit 250: UA0005703.

<sup>87</sup> Exhibit 251: UA0005781.

The transactions involving the Ministry of Health, Tri-TsAS, and Eurostate, as well as the ownership of the relevant corporations, are illustrated in the chart on the following page.



Tri-Tsentralny AS Contract



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**E. Sumskaya**

A transaction involving a fifth company was also within the scope of our review but did not reveal evidence as striking as that surrounding the previous four companies discussed. Unlike those contractors, Sumskaya Aptechna Kompaniya (“Sumskaya”) did not appear to contract with foreign intermediaries and shell companies. Instead, the company contracted with the Ukrainian intermediaries OJSC Ganza (an entity that formerly owned part of Sumskaya) and Pharmacevtychni preparaty regioniv LLC (a losing bidder on the Ministry contract), as well as two Ukrainian manufacturers, OJSC Luhansk Chemical Pharmaceutical Plant and Borshchagivskyi Chemical Pharmaceutical Plant. One contract between Sumskaya, the MHU, and Ukrvaksina was reviewed.

**1. *Bidding Process***

Sumskaya was the lowest bidder in the tender process. The only other bidders on the tender were Pharmacevtychni preparaty regioniv LLC and Alter Ego LLC.<sup>88</sup>

Sumskaya ultimately purchased some of the medicines from losing bidder

Pharmacevtychni preparaty regioniv LLC.

No.	Medicine	Bidder	Bid Price
1	Anti-Tuberculosis Preparation	Sumska Aptechna Kompaniya LLC Pharmacevtychni Preparaty regioniv LLC Alter Ego LLC	47,461,615.21 грн. 54,914,295.00 грн. 57,408,772.66 грн.

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<sup>88</sup> Exhibit 252: UA0003262-3263.

## 2. Government Contract

The MHU, Sumskaya, and state enterprise Ukrvaksina signed Government Contract 1/12 on May 23, 2008 for the provision of multiple pharmaceutical products totaling UAH 47,460,193, as follows:<sup>89</sup>

Product	Quantity	Price per unit	Total	Manufacturer
Isoniazid 10% 5ml	1,230,730.00	0.69	849,203.70 грн.	Lupin LTD, India
Combutol 400mg	11,055,000	0.16	1,768,800.00 грн.	Lupin LTD, India
Ripafex 150mg	344,448	13	4,477,824.00 грн.	Lupin LTD, India
Pyzina 500mg	12,056,000	0.17	2,049,520.00 грн.	Lupin LTD, India
R-cin 150 mg	24,489,000	0.165	4,040,685.00 грн.	Lupin LTD, India
Rifapentine 150mg	344,300	13.00	4,475,900.00 грн.	OOO Pharma Life
Sensicult	45,444	159	7,225,596.00 грн.	Tulip Diagnostics Ltd., India
Streptomycin-KMP	1,914,704	1.2	2,297,644.80 грн.	KMP OAO Kyivmedpreparat
SCC	4,203,800	1.5	6,305,700.00 грн.	Svizera, India
Isoniazid syrup 100/5	18,317	30	549,510.00 грн.	TOV Yuriya-Farm
Isoniazid 0.3 tab.	19,700,000	0.069	1,359,300.00 грн.	OAO Lugansky CPP
Pirasinamid 0.5g	12,054,000	0.17	2,049,180.00 грн.	OAO Lugansky CPP
Etambutol 0.4g	11,055,200	0.16	1,768,832.00 грн.	OAO Lugansky CPP
Isoniazid 100mg	13,966,000	0.0274	382,668.40 грн.	ZAO RDC Borshagovsky CPP
Pirasinamid 500mg	12,058,000	0.17	2,049,860.00 грн.	ZAO RDC Borshagovsky CPP
Rifampicin 150mg	24,490,000	0.165	4,040,850.00 грн.	ZAO RDC Borshagovsky CPP
Etambutol 400mg	11,057,000	0.16	1,769,120.00 грн.	ZAO RDC Borshagovsky CPP
<b>Total</b>			<b>47,460,193.90 грн.</b>	

The contract stipulates that Ukrvaksina shall make a 100 percent prepayment to Sumskaya. The contract is signed by Deputy Minister of Health Z.M. Mytnyk on behalf of MHU and General Director H.M. Vorona on behalf of Sumskaya.

<sup>89</sup> Exhibit 253: UA0001148-54.

### 3. *Contracts with Ukrainian Intermediaries*

In order to fulfill the government contracts, Sumskaya contracted directly with two Ukrainian manufacturers, OJSC Luhansk Chemical Pharmaceutical Plant and Borshchagivskiy Chemical Pharmaceutical Plant, and also utilized two Ukrainian intermediaries, CJSC Ganza and Pharmacevtychni preparaty regioniv LLC.<sup>90</sup> The two contracts with the Ukrainian manufacturers were concluded prior to the contract between Sumskaya and the MHU. Pharmacevtychni preparaty regioniv – one of the losing bidders in the tender process – provided Sumskaya with UAH 20,397,151.11 worth of pharmaceutical products. Ganza supplied UAH 13,129,297.30 worth of medications. Approximately 70 percent of the total value of goods supplied to the MHU were procured through local intermediaries rather than directly from the manufacturers.

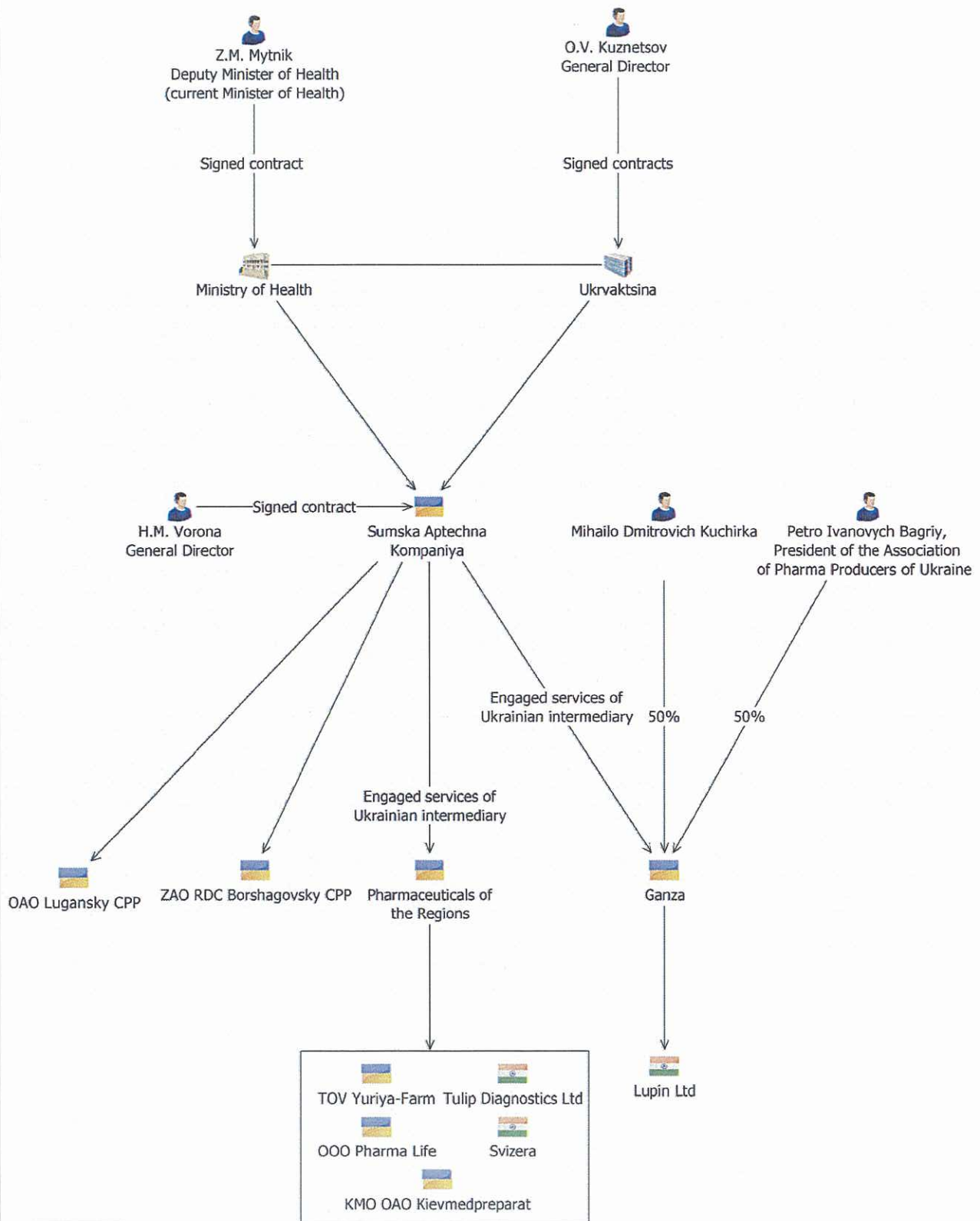
Moreover, Sumskaya and Ganza were formerly related entities. Ganza held a 25 percent stake in Sumskaya from April 17, 2006 to March 21, 2008 – approximately three months before Ganza and Sumskaya entered into their supply contract. As discussed above, Ganza was founded by and is currently co-owned by Mikhail Dmitrievich Kuchirk and Petro Ivanovich Bagriy. The media reports that Bagriy is a business partner of Yury Konstantinov, the Head of the MHU's department on regulatory policy in the area of turnover of medications in the healthcare system. Bagriy and Konstantinov co-founded together TOV Matrix and TOV Emergencia 2004.

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<sup>90</sup> Exhibit 254: UA0002819-UA0002846.

The transactions involving the Ministry of Health, Sumskaya, and other entities, as well as the ownership of the relevant corporations, are illustrated in the chart on the following page.

# Sumska Aptechna Kompaniya Contract



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## **VI. Conclusions and Recommendations**

This investigation revealed evidence of fraud and waste of Government funds in the procurement process at the Ministry of Health. The same Ukrainian companies repeatedly win government contracts, and evidence suggests that some collude in bidding on contracts and that others have connections within the Ministry. Those companies then enter into purported “supply” contracts with foreign shell companies and report that contract price as the customs value when the goods are imported into Ukraine. This conceals the manufacturer’s prices – and the markup that the Ukrainian company is charging over those prices – from the Government. In the absence of evidence to the contrary, the most reasonable conclusion to draw is that the foreign intermediaries exist only to mask the lower manufacturer’s price and facilitate a mark-up to the Government that exceeds the permitted 10 percent. Many aspects of the current procurement procedure within the Ministry of Health allow these corrupt practices to continue.

However, greater transparency and stricter monitoring of tender process could help to prevent consistent dealing with companies that have close ties to the Ministry, particularly if other companies can offer a better price or more favorable terms. More comprehensive due diligence relating to other bidders is also necessary, in order to determine if the tender process is being manipulated by parties colluding to ensure that one wins but all benefit. Better intelligence on market prices for the goods desired – rather than looking to prices paid the previous years, which perpetuates markups – would enable the government to use its strong negotiating position to obtain more favorable deals.

Reevaluation of certain regulations that govern procurement could also be helpful to putting an end to these practices. For example, the decrees relating to the permissible level of markup allow contractors to list only the customs value, and companies apparently have some discretion in listing a customs value. This promotes the use of additional intermediaries to conceal the true value of the goods and to circumvent the 10 percent limit.

Regulations providing that a tender is valid so long as two bidders participate also enable collusion. Changing the law to require three or four viable bids on tenders exceeding a threshold monetary value could improve the likelihood of a competitive process. Giving the MHU the authority to negotiate prices could also increase the probability of a competitive bidding process, provided there is careful oversight to protect against inappropriate relationships between government officials and private contractors.



# **INVESTIGATION RELATING TO LAND REGISTRATION PROGRAM ENACTED BY THE CABINET OF MINISTERS**

## **Table of Contents**

<b>I.</b>	<b>Introduction .....</b>	<b>162</b>
<b>II.</b>	<b>Executive Summary .....</b>	<b>163</b>
<b>III.</b>	<b>Investigative Findings .....</b>	<b>164</b>
	<b>A. Development of Legislation Underlying Land Registration Program .....</b>	<b>164</b>
	1. <i>Introduction of Draft Decree No. 844.....</i>	164
	2. <i>Issuance of Decree No. 844 Implementing Land Registration Program .....</i>	165
	3. <i>Amendments to Decree No. 844 .....</i>	166
	<b>B. Cabinet of Ministers Failed to Comply with Procedures for Issuing Decree No. 844.....</b>	<b>167</b>
	<b>C. The Stabilization Fund Was Used For An Unauthorized Purpose.....</b>	<b>168</b>
	1. <i>General information on the Stabilization Fund of Ukraine.....</i>	168
	2. <i>Use of the Stabilization Fund to finance Land Registration Program .....</i>	168
<b>IV.</b>	<b>KRU Findings that the Audit Has Not Confirmed .....</b>	<b>170</b>
	<b>A. Expenditure of Funds for Small Benefit .....</b>	<b>170</b>
	<b>B. Engagement of Subcontractors for Purposes of Carrying Out the Land Registration Program .....</b>	<b>170</b>
	<b>C. Losses Incurred by the Ukrainian State Enterprise of Post (“Ukrposhta”) .....</b>	<b>173</b>
	<b>D. Compulsion of the Citizens to Turn to Private Companies and Pay for Services That They Were Supposed to Receive Free of Charge Under Decree No. 844 .....</b>	<b>173</b>
	<b>E. Performance under Decree No. 844 by the DKZ, SCLC and their Regional Sub-Divisions .....</b>	<b>174</b>
<b>V.</b>	<b>Conclusions and Recommendations.....</b>	<b>176</b>

## **I. Introduction**

This report discusses a land registration program that was implemented by the Cabinet of Ministers and financed through the Stabilization Fund. The Investigative Firms focused on the failure of the Cabinet of Ministers to obtain the necessary approval of Parliament to utilize the Stabilization Fund for the land registration program. The Main Control and Revision Office (the “KRU”) also found that intermediaries and contractors received substantial funds in connection with the project, but only a small percentage of the budgeted plots were registered. The aim of this investigation only was to audit and confirm the findings of the KRU but did not include a comprehensive forensic audit or interviews of relevant officials as the other investigative projects did.

The investigation conducted with respect to this report is governed by the following sections of the Terms of Reference:

- Record keeping, preservation and use of land resources, including in respect of free-of-charge registration and issuance to individuals of state acts on rights to ownership to land plots.” Terms of Reference I.3.
- Evaluation with respect to compliance with the legislation of Ukraine, international law and practice in all areas set out in these Terms of Reference. Terms of Reference II.
- Conclusion on impact of discovered violations on the state economy. Terms of Reference II.
- Proposals regarding specific measures for improvement of the financial and economic situation in the state. Terms of Reference II.

## **II. Executive Summary**

On August 5, 2009, the Cabinet of Ministers issued Decree No. 844 on the Implementation of the rights to obtain ownership rights to land plots by the citizens of Ukraine.” The decree allowed for citizens to register their ownership of land plots, free of charge. The land registration program was to be implemented by the State Committee on Land Resources, known as DerzhKomZem (“DKZ”). The initial amount of financing for the decree was UAH 5,953,800,600, but that amount was subsequently reduced to UAH 507,784,800. DKZ budgeted that this amount would enable 6.4 million citizens to register their land.

The money to finance the land registration project was taken from the Stabilization Fund of Ukraine, which was established in October 2008 to support the economy during the global recession (for example, by providing support to Ukrainian banks and implementing investment projects). In this case, however, the money in the Stabilization Fund was used on a project with unrealistic objectives for free land registration, which was launched shortly before the 2010 elections. The use of the Stabilization Fund for this particular purpose, which was not specified in the legislation establishing the Fund, and for which the Cabinet of Ministers did not obtain the required approval of the Parliamentary Committees on Budget and on Finance and Banking, was improper. At the highest level of government, funds that were reserved for specific purposes were applied to a different purpose without the requisite approval.

In addition, KRU found that as of January 1, 2010, UAH 298 million had been spent on issuing only 620,000 state acts of ownership. KRU also concluded that a

substantial portion of that sum was given to private contractors. However, the Investigative Firms have not obtained the documents necessary to confirm these findings.

### **III. Investigative Findings**

#### **A. Development of Legislation Underlying Land Registration Program**

##### **1. *Introduction of Draft Decree No. 844***

On or about August 3, 2009, a draft decree entitled “Certain Issues Concerned with Implementation of the Rights to Obtain Freehold Title to Land Plots by the Citizens of Ukraine” was submitted to the Cabinet of Ministers. An explanatory note attached to the draft decree and signed by DKZ head Oleg Kulinich outlined the decree’s purposes.<sup>1</sup> According to a source, DKZ was instructed by former Prime Minister Yulia Tymoshenko to prepare the draft decree and submit it for approval.<sup>2</sup>

The draft decree was intended to allow citizens to register their ownership of land plots free of charge. The right to obtain ownership rights to the plots that are owned by the state is vested in the citizens in accordance with Article 14 of the Constitution of Ukraine<sup>3</sup> and Article 121 of the Land Code of Ukraine.<sup>4</sup> According to the explanatory note to the draft decree, despite the fact that the Land Code of Ukraine stated that citizens did not have to pay to register their land plots, land registrants had been forced to pay for various related services. The objective of the proposed draft decree was to prohibit charging citizens for the provision of any kind of services associated with state registration of land ownership. The explanatory note also indicated that the DKZ was to

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<sup>1</sup> Exhibit 255: UA0003511.

<sup>2</sup> Interview of confidential source, September 23, 2010.

<sup>3</sup> Constitution of Ukraine, adopted at the 5th session of the Verkhovna Rada of Ukraine on 28 June 1996.

<sup>4</sup> Land Code of Ukraine 25.10.2001 № 2768-III

register land plots to approximately 6,792,000 citizens. According to the KRU, this number was calculated by DKZ based on the information supplied by its regional sub-divisions.<sup>5</sup>

The draft decree was approved by Economics Minister Bogdan Danilishin, First Deputy Environment Protection Minister Ivan Chornokur, and Head of the State Committee for Regulatory Policy and Entrepreneurship Olexandra Kuzhel.<sup>6</sup> The date of the approval was not indicated.

According to the KRU, on August 4, 2009, the First Deputy Minister of Justice submitted a note with a number of comments to the proposed draft decree to the Cabinet of Ministers. The comments referred to, among other things, certain inconsistencies between the proposed decree and Ukrainian legislation.

## 2. *Issuance of Decree No. 844 Implementing Land Registration Program*

Despite the concerns documented by the Justice Ministry, on August 5, 2009, the Cabinet of Ministers issued and Prime Minister Tymoshenko signed Decree No. 844, entitled “Certain Issues Concerned with Implementation of the Rights to Obtain Ownership Rights to Land Plots by the Citizens of Ukraine in 2009.”<sup>7</sup> The Decree specified the procedures to be followed in order to issue certificates or “state acts” of land registration, enabling citizens to formalize their private ownership of land plots. DKZ and its regional sub-divisions were ordered to organize the acceptance of applications to register land plots and to process all paperwork required for such registration. In

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<sup>5</sup> Interview of confidential source, September 23, 2010.

<sup>6</sup> Exhibit 256: UA0003516.

<sup>7</sup> Exhibit 257: UA0003502-3503.

fulfilling these tasks, DKZ was instructed to engage the Center of the State Land Cadastre (“CSLC”) and other state bodies and enterprises reporting to DKZ. All entities were required to hold licenses for land surveying and development. In order to implement the objectives of Decree No. 844, the number of employees of DKZ and its regional sub-divisions was to be increased up to 335 and 14,374, respectively. The budget allocated for the project under Decree No. 844 was UAH 5,953,800,600. The money was ordered to be taken from the Stabilization Fund of Ukraine, which is described in more detail below.

On August 7, 2009 the Secretariat of the Cabinet of Ministers sent a letter to the Ministry of Justice of Ukraine requesting its approval of Decree No. 844.<sup>8</sup> In its response of August 10, 2009,<sup>9</sup> the Ministry of Justice emphasized the breach of the order of approval of the draft decree of the Cabinet of Ministers by DKZ as the decree’s chief developer. In other words, the DKZ should have first submitted the draft decree to the Ministry of Justice for approval, and only then could the decree have been approved by the Cabinet of Ministers. The Ministry of Justice repeated all of its comments set out in its note to the draft decree, including that the land registration program would conflict with certain Ukrainian legislation and that the Cabinet of Ministers had also failed to follow required procedures for utilizing proceeds in the Stabilization Fund.

### 3. *Amendments to Decree No. 844*

On September 9, 2009, the Cabinet of Ministers issued Decree No. 951, which reduced the land registration program’s budget from UAH 5,953,800,600 to UAH

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<sup>8</sup> However, the Investigative Firms have not reviewed this letter.

<sup>9</sup> Exhibit 258: UA0003522.

507,784,800.<sup>10</sup> Of that amount, UAH 32,810,100 was allocated for the increase of the number of DKZ staff members. The remaining sum was intended to be spent on notifying the citizens of the land registration program and on preparing the documentation relating to registration of ownership rights. The reason that the budget was reduced is unclear. The “passport” of the budget program submitted to the State Treasury of Ukraine in connection with implementation of the project provided for 6.4 million registrations to be carried out in 2009.

On October 21, 2009, reference to the year 2009 was removed from the title and the body of Decree No. 844 pursuant to Decree No. 1112 issued by the Cabinet of Ministers.<sup>11</sup> The Ministry of Finance was instructed to make provisions in the 2010 annual state budget to finance the land registration program. Decree No. 844 was further amended in December 2009, January 2010 and June 2010, in order to bring it into conformity with other legislative acts of Ukraine and refine the procedure of land registration.

**B. Cabinet of Ministers Failed to Comply with Procedures for Issuing Decree No. 844**

According to the letter of the Ministry of Justice dated August 10, 2009, DKZ, in its capacity of the chief developer of the legislative act, should have submitted a draft Cabinet of Ministers Decree for approval to the Ministry of Justice along with all of the underlying and supplementary materials pursuant to the Regulations on the Cabinet of

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<sup>10</sup> Exhibit 259: UA0003527.

<sup>11</sup> Exhibit 260: UA0003535 and UA0003538

Ministers. The approval of the Ministry of Justice was not obtained, and the comments submitted by the Ministry of Justice were neglected.

**C. The Stabilization Fund Was Used For An Unauthorized Purpose**

**1. *General information on the Stabilization Fund of Ukraine***

The Stabilization Fund of Ukraine was established in accordance with Law No. 639-VI of October 31, 2008 as part of the state budget.<sup>12</sup> The main purpose of the Stabilization Fund was to minimize the negative impact of the financial crisis on the economy of Ukraine. Funds can be used, for example, to stabilize banks or to support investment, and can be provided on returnable or non-returnable basis. In accordance with Law No. 639-VI the monies in the Stabilization Fund can be used at the order of the Cabinet of Ministers. However, Law No. 639-VI requires that any Cabinet of Minister's order to use such funds be approved by two Committees of the Verkhovna Rada: the Budget Committee and the Committee on Finance and Banking. In addition, the law requires that the Ministry of Finance be consulted.

**2. *Use of the Stabilization Fund to finance Land Registration Program***

Pursuant to the Regulations on the Use of the Moneys of the Stabilization Fund in 2009, which was approved by Cabinet of Ministers Decree No. 289,<sup>13</sup> any decision on the use of the Stabilization Fund money should be preceded by the approval of the Ministry of Finance. Furthermore, as noted above, according to Law 639-VI of October 31, 2008, disbursements from the Stabilization Fund must be approved by the Parliamentary

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<sup>12</sup> Exhibit 261: UA0003482; Exhibit 262: UA0005837.

<sup>13</sup> Exhibit 263: UA0005833.



Committees on Budget and on Finance and Banking. However, the Cabinet of Ministers did not obtain any of the required approvals.

Instead, Cabinet of Ministers Decree No. 844 authorized the use of UAH 507,784,800 from the Stabilization Fund to implement the land registration program. Then, Decree No. 951 clarified that amounts that were previously allocated to support the State Savings Bank and the State Export-Import Bank of Ukraine should be decreased by the total sum of UAH 507,784,800. Those funds would instead be used to finance the Land Registration Program under Decree No. 844.<sup>14</sup> Finally, on December 8, 2009, former Prime Minister Tymoshenko instructed the State Treasury to make disbursements from the Stabilization Fund to facilitate land registration.<sup>15</sup> The disbursements were to finance the preparation of “technical documentation” for registering land ownership.

Thus, instead of providing financial support to state banks and enterprises or combating the effects of the recession, the Cabinet of Ministers unilaterally used the Stabilization Fund to finance a Land Registration Program that had nothing to do with the intended use of the Stabilization Fund, but would presumably curry political favor with the citizenry, shortly before the elections. Moreover, the Cabinet of Ministers disregarded input from the Ministry of Justice and failed to obtain approval from two Committees of the Verkhovna Rada, as required by law before using Stabilization Fund resources.

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<sup>14</sup> Exhibit 264: UA0003529.

<sup>15</sup> Exhibit 265: UA0003974.

#### **IV. KRU Findings that the Audit Has Not Confirmed**

##### **A. Expenditure of Funds for Small Benefit**

Pursuant to the “passport” of the budget for Decree No. 844, the total number of land registration certificates to be issued by DKZ during the period from August 5, 2009 until the end of 2009 should have amounted to 6,400,000. According to calculations performed by the KRU and the CSLC, as of January 1, 2010, approximately 620,000 certificates have been issued, which equals to 10% of the amount planned.<sup>16</sup> At the same time, the amount of funding provided from the Stabilization Fund as of January 1, 2010 amounted to approximately UAH 280 million, which represents almost 60% of the total budget allocated for the project.

##### **B. Engagement of Subcontractors for Purposes of Carrying Out the Land Registration Program**

The first step of implementation of Decree No. 844 for DKZ was to notify the citizens of Ukraine to whom land plots have been allocated of the possibility to apply to obtain ownership rights to such land plots on free-of-charge basis. For this purpose, DKZ subcontracted with Ukrainian Mailing Centre LLC (“UMC”) at a total cost of UAH 10,224,791.46.<sup>17</sup>

When UMC entered into the agreement with DKZ on September 24, 2009, the company did not have a license to provide the required services. A license to send ordinary and registered letters, post cards and parcels up to 30 kg in Ukraine was only issued to UMC on December 15, 2009.<sup>18</sup> UMC was incorporated on June 26, 2009 and

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<sup>16</sup> Exhibit 266: UA0003965.

<sup>17</sup> Exhibit 267: UA0004998, UA0005003, UA0005005, UA0005006.

<sup>18</sup> Exhibit 268: UA0004997.

is registered at 82 Frunze Str, Kyiv, 04080. The director of UMC is Gamretskyj Vitalij Mykolayovych and the company's nature of business is listed as printing activity, mediation in goods trade, retail trade of non-food items, and other commercial services.<sup>19</sup>

The Acts of Acceptance dated October 8 and 15, 2009 confirm that a total of 5,712,174 notification letters were sent to individuals.<sup>20</sup> Wire transfer instructions dated November 17, 2009 confirm that DKZ paid the full amount of more than UAH 10 million to UMC.<sup>21</sup> DKZ provided UMC with a template of the letter to distribute and a list of the individuals, who should have received notifications.<sup>22</sup> The Investigative Firms have not independently determined how the list was compiled.

According to the KRU, UMC subcontracted its work to at least eight other private companies, for a total value of UAH 9,342,967.96.<sup>23</sup>

- August 25, 2009 Agreement with Fodzha LLC: UMC paid Fodzha UAH 1,107,000 to buy 6,150,000 C65 envelopes..
- September 3, 2009 Agreement with August Trade LLC: UMC paid August Trade UAH 2,940,000 to deliver letters for an estimated price of (UAH 0.42 per letter.<sup>24</sup>

According to the Acts of Acceptance dated October 8 and 15, 2009, 5,712,174 letters were delivered for a total cost of UAH 2,399,113.08.<sup>25</sup>

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<sup>19</sup> Exhibit 269: UA0004995.

<sup>20</sup> Exhibit 270: UA0005012.

<sup>21</sup> Exhibit 271: UA0005016.

<sup>22</sup> Exhibit 272: UA0005007.

<sup>23</sup> Exhibit 273: UA0003969; Exhibit 274: UA0005037.

<sup>24</sup> Exhibit 275: UA0005018.

<sup>25</sup> Exhibit 276: UA0005027-UA0005028.

- September 24, 2009 Agreement with August Trade LLC: UMC paid August Trade UAH 882,000 to produce blank forms (UAH 0.126 per form).<sup>26</sup> According to consignment notes, August Trade produced 5,650,000 forms for a total price of UAH 711,900.<sup>27</sup>
- September 24, 2009 Agreement with Multipost LLC: UMC paid Multipost UAH 162,530 to prepare and address letters. According to the Act of Acceptance dated October 15, 2009, Multipost LLC addressed 500,000 documents for UAH 150,000 and prepared 125,300 documents for UAH 12,530, totaling UAH 162,530.
- September 24, 2009 Agreement with the Ukrainian State Enterprise of Postal Services, Ukrposhta: UMC paid Ukrposhta UAH 3,740,000 to print and prepare items for mailing. According to the Act of Acceptance dated September 30, 2009, Ukrposhta provided services amounting to UAH 552,000.
- September 25, 2009 Agreement with Ukrposhta. UMC paid Ukrposhta UAH 122,384.88 for printing and preparing items for. According to the Acts of Acceptance dated October 13 and 16, 2009, 1,019,874 letters were processed for a total cost of UAH 122,384.88.
- September 25, 2009 Agreement with BFO Expert LLC: UMC paid BFO Expert UAH 3,740,000 for the processing of electronic databases.. According to the Acts of Acceptance dated October 12, 2009 and November 26, 2009, BFO Expert LLC provided services in relation to 8,500,000 records amounting to a total cost of

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<sup>26</sup> Exhibit 277: UA0005029.

<sup>27</sup> Exhibit 278: UA0005032.

UAH 3,740,000. However, KRU found no evidence that UMC made any payments to BFO Expert LLC under this agreement.

- October 24, 2009 Agreement with Power-Print LLC. UMC paid Power-Print UAH 548,040 for printing and preparing items for mailing. According to the Act of Acceptance dated October 1, 2009, services provided by Power-Print LLC amounted to UAH 548,040.

**C. Losses Incurred by the Ukrainian State Enterprise of Post (“Ukrposhta”)**

The Ukrainian State Enterprise of Post, Ukrposhta, was responsible for notifying individuals of their right to register land.. The cost of their services amounted to UAH 2.4 million, which we have not been able to independently confirm. According to the KRU report, the services provided by Ukrposhta were provided at rates lower than those recommended by the National Commission on Communications of Ukraine. As a result, the KRU calculated that Ukrposhta incurred a loss of UAH 6 million in providing these services. However, the Investigative Firms were not able to access any documentary evidence relating to this issue and cannot provide any confirmation of the KRU’s findings.

**D. Compulsion of the Citizens to Turn to Private Companies and Pay for Services That They Were Supposed to Receive Free of Charge Under Decree No. 844**

During a KRU site visit at the Sevastopol regional division of SCLC, the KRU was informed that an individual entrepreneur, located on the premises of the SCLC, provided commercial services in connection with registration of ownership rights to land plots. These services were identical to the ones that were supposed to be provided by the SCLC free of charge under Decree No. 844.

The Head of the Sevastopol regional division of the SCLC informed an individual who was entitled to receive free land registration services that preparation of the technical documentation by the department would take more than 30 days under the procedures prescribed by Decree 844. Instead, this regional SCLC official recommended that the individual use the services of the entrepreneur in the next office, which would cost the individual UAH 1,250 but would take less time.<sup>28</sup> This figure was confirmed by a receipt provided by the individual who used this individual entrepreneur's services.<sup>29</sup> The receipt indicated that the individual entrepreneur was Natalia Viktorivana Tsvetkova, who, according to KRU, is the daughter of the Head of the Sevastopol regional division of SCLC.

According to the KRU calculations, which we have been unable to independently confirm, a total of UAH 3.3 million was paid to this individual entrepreneur.

**E. Performance under Decree No. 844 by the DKZ, SCLC and their Regional Sub-Divisions**

The KRU reports that the quality of work carried out by the DKZ, SCLC and their regional sub-divisions plots was poor. The KRU report makes the following allegations that the Investigative Firms have been unable to independently confirm:

- More than 180,000 notifications sent to the individuals were returned to the regional subdivisions of Ukrposhta. The reasons given for their return included incorrect addresses and deceased residents. KRU estimated that the cost of

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<sup>28</sup> Exhibit 279: UA0003978.

<sup>29</sup> Exhibit 280: UA0003977.

preparing these notifications amounted to UAH 280,000.<sup>30</sup> From the information available, the Investigative Firms have not been able to independently confirm these calculations.

- In approximately 165,000 cases, the packages of technical documents prepared for the issuance of certificates were incomplete or did not meet the requirements of the legislation. Therefore, a state act on land ownership rights could not be issued. KRU calculated that the cost of preparing these insufficient technical packages amounted to UAH 12 million.<sup>31</sup> The current status of these packages is unknown. From the information available, the Investigative Firms have not been able to independently confirm these calculations.
- The regional departments of the SCLC and the regional institutes of land use reportedly engaged the services of private companies to produce the packages of technical documents required for the issuance of certificates. According to the KRU report, the total cost of these private companies amounted to UAH 1.4 million. From the information available, the Investigative Firms have not been able to independently confirm whether or not these companies have been paid, nor have we independently confirmed the accuracy of the calculation of the total cost of services of subcontractors made by the KRU.
- In approximately 900 cases, individuals had already personally paid to register their land, but DKZ paid to re-register the same plots. According to the KRU calculations, the total loss of state funds associated with this issue amounts to

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<sup>30</sup> Exhibit 281: UA0003878.

<sup>31</sup> *Id.*

UAH 1 million. From the information available, the Investigative Firms have not been able to independently confirm these calculations.

- Approximately 1,400 blank, official land certificates bearing unique numbers and holograms are missing from five regional offices. The KRU subsequently identified that some of these missing certificates were used in an attempt to register land plots in the Kyiv region. From the information available, the Investigative Firms have not independently confirmed this finding.

## **V. Conclusions and Recommendations**

The Cabinet of Ministers enacted the Land Registration Program, in the lead-up to the 2010 elections. The Cabinet of Ministers financed the Land Registration Program by evading the procedures prescribed by law for utilizing the Stabilization Fund. The Cabinet of Ministers and former Prime Minister Tymoshenko failed to consult the Ministry of Finance and similarly failed to obtain the required approval of Parliamentary Committees before ordering the transfer of monies out of the Stabilization Fund. These actions were in violation of Ukrainian law and threatened the integrity of the Stabilization Fund.

As with the investigation relating to the use of funds obtained through the sale of carbon credits under the Kyoto Protocol, this is a case of funds being designated for one purpose and then applied, without proper approval, for another purpose.